Marks and Spencer Financial Services Plc

Registered No: 1772585

Annual Report and Financial Statements for the year ended 31 December 2020

HSBC

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Strategic Report

Principal activities

Marks and Spencer Financial Services Plc ('the Entity') is a public company incorporated in the United Kingdom. Its trading address is Kings Meadow, Chester Business Park, Chester CH99 9FB. The Entity is limited by shares.

Marks and Spencer Financial Services Plc, trading as M&S Bank, is an authorised bank under the Financial Services and Markets Act 2000, authorised by the Prudential Regulation Authority ('PRA') and regulated by the Financial Conduct Authority ('FCA'). The Entity's principal activity is the provision of retail banking financial services to both Marks and Spencer plc (M&S plc) and non M&S plc customers.

The main products provided by the Entity are credit cards, unsecured personal loans, mortgages, general insurance, savings accounts, travel money, no monthly fee current accounts and fee based premium club and premium current account products.

A relationship agreement is in place with M&S plc which provides financial incentives to M&S plc for ongoing profitable development of the entity.

Review of the Entity's business

The Entity's business has been materially impacted by the Covid-19 pandemic during the year. Restrictions imposed on businesses and individuals have resulted in disruption to both trading and operational processes, and the Entity's customers have faced significant challenges. The most material impacts to trading have been seen through reduced credit card spend and borrowing and reduced travel money turnover due to very little international travel taking place and the Entity having to close its branch and bureaux network for extended periods during the year.

Operationally, the Entity was able to move rapidly to a remote working model in March, and has maintained resilient operational delivery throughout the remainder of 2020, with the vast majority of colleagues continuing to work from home. Disruption due to staff absence resulting from the pandemic has also been minimal.

The Entity has delivered numerous solutions to support customers including payment holidays, extended loyalty voucher periods, suspended fees on premium club current accounts and removed interest penalties for early redemption of fixed rate savings products. A number of initiatives have been introduced to support vulnerable customers and changes to digital offerings have been implemented to enable more customers to access self-service capability.

Despite the challenges posed by the pandemic, the Entity has continued to work closely with M&S plc and HSBC UK to develop and drive forward an aligned strategy, leveraging the strengths and capabilities of the businesses. This will see an increased focus on unsecured lending, payments and travel propositions.

The short to medium term economic outlook remains uncertain, with any recovery from the pandemic likely to be influenced heavily by the speed and effectiveness of the Covid-19 vaccination programme. The Entity will continue to support customers during this period whilst ensuring that staff remain safe and operational capability is maintained.

Performance

The Entity's results for the year under review are as detailed in the income statement shown on page 18 of these financial statements.

The table below illustrates the differences in reported loss to adjusted (loss)/profit before tax.

	2020	2019
	£m	£m
(Loss)/profit before tax	**(36)**	(86)
PPI Remediation	**(18)**	212
NOSIA Remediation	**–**	13
Skilled person review Remediation	**22**	15
Profit Share impact of additional Remediation	**7**	(78)
Adjusted (loss)/profit before tax	**(25)**	76

The Entity reported a loss before tax for the year in 2020 of £36m compared with a loss of £86m in 2019.

The year on year movement reflects a £106m decrease in net operating income before impairment charges, a £86m increase in loan impairment charge and a £242m decrease in operating expense.

The decrease in operating income is driven primarily by reductions in credit card and travel money income, which were materially impacted by the Covid-19 pandemic, and by the inclusion of additional redress relating to the Skilled Person Review of HSBC Collections and Recoveries activity (set out in Note 20 of the financial statements). As a result of lockdowns imposed, during 2020 credit card spend fell by 22% compared with 2019 and whilst there was some recovery during the latter half of the year interest bearing balances were 22% lower at the end of the year. The closure of bureaux and travel restrictions resulted in a reduction of 80% in travel money turnover. This is offset by an increase in the profit share asset with M&S plc as a result of reduced trading performance, increased loan impairment charges and increased additional remediation charges. The year on year movement in operating income also includes additional redress (£22m) relating to the Skilled Person Review of HSBC Collections and Recoveries strategies. The £86m higher loan impairment charge is driven primarily by changes to Forward Economic Guidance provisions owing to the deteriorating economic situation due to Covid-19, which have increased recognition of expected credit losses (ECL).

The reduced operating expenses reflect the reduction in PPI provisions - £18m release (£212m additional provisions in 2019).

Excluding customer remediation, the business generated an adjusted loss before tax of £26m (2019: £76m profit).

The year on year adjusted movement reflects a £22m decrease in net operating income before impairment charges, an £86m increase in loan impairment charge and a £6m decrease in operating expenses.

Adjusted operating income (adjusted for the impact of customer remediation) was £22m lower compared with 2019, with a £39m decrease in net interest income due to lower interest income across credit card and personal loan products impacted by Covid-19 offset by lower interest payable on customer accounts due to low interest rates and reducing balances. Other income including net fee income was higher by £17m driven by lower travel money income due to the impact of Covid-19 on foreign currency sales offset by higher profit share payable to M&S plc. The movement in profit share reflects the impact of the lower adjusted business performance, mainly driven by higher loan impairment charges and Covid-19 impacts.

Adjusted operating expenses (adjusted for the impact of customer remediation) are £6m favourable compared with prior year, reflecting ongoing focus on cost management within the business.

Key performance indicators

The Directors use Key Performance Indicators ('KPIs') to monitor the business. As well as the income statement and the balance sheet, these indicators include measures to identify the returns on different categories of assets and the risks to which the Entity is exposed.

Financial KPIs

	2020	2019
(Loss)/Profit Before Tax (£'m)	**(36)**	(86)
Adjusted profit before tax (£'m)	**(26)**	(76)
Total risk-weighted assets (£'m)	**2,677**	3,025
Pre-tax return on risk-weighted assets (%)	**(0.9)**	2.7
Common equity tier 1 (%)	**15.5**	12.3
Cost efficiency ratio (%)	**48.4**	48.0
Return on tangible equity (%)	**(6.8)**	16.3
Ratio of customer advances to customer deposits (%)	**148.7**	194.9

Adjusted (loss)/profit and adjusted operating expenses exclude customer remediation.
Pre-tax return on average risk-weighted assets is measured as adjusted (loss)/profit before tax divided by average risk-weighted assets. This has fallen year on year due to the loss before tax reported in 2020.

Common equity tier 1 capital comprises shareholders' equity less regulatory deductions and adjustments. The Entity maintains a strong capital base to support the development of its business and meet regulatory capital requirements at all times. This has increased year on year due to higher capital resource within the Entity and lower risk weighted assets.

Cost efficiency ratio is measured as total adjusted operating expenses divided by adjusted operating income before loan impairment and other credit risk provisions. This has remained largely unchanged during the year as a result of cost management within the Entity.

Return on tangible equity (RoTE) is defined as the adjusted profit attributable to ordinary shareholders, adjusted for Additional Tier 1 coupons, divided by average ordinary shareholders' equity, adjusted for other intangibles. The fall year on year reflects its higher average capital in force and lower adjusted business performance.

Ratio of customer advances to customer deposits comprises loans and advances to customers as a ratio of the total customer deposits. This has reduced year on year due to lower customer assets.

Non-financial KPIs monitored include employee engagement, which measures employees' emotional and intellectual commitment to the Entity, and customer satisfaction.

Significant accounting judgements

The following are the key areas of accounting judgements affecting the Entity:

- Customer Remediation - this is covered in Note 20;
- Effective interest rate - this is covered in Note 13;
- Loan impairment - this is covered in Note 26.

Key judgements underpinning these have been considered by the Board.

Principal risks and uncertainties

An established risk governance framework and ownership structure ensures oversight of, and accountability for, the effective management of risk. The Entity's Risk Management Meeting meets six times a year focusing on risk governance and providing a forward looking view of risks and their mitigation.

In carrying out its responsibilities the Risk Management Meeting is closely supported by the Chief Risk Officer, the Chief Financial Officer, the Head of Internal Audit and Compliance, together with other business functions on risks within their respective areas of responsibility.

Principal financial risks and uncertainties facing the Entity are credit risk, market risk and liquidity risk. These risks, the exposure to such risks and management of risk are set out in Note 26 of the financial statements.

The most important non-financial types of risk are operational risk, conduct and regulatory risk, including financial crime compliance, reputational risk and cyber risk. The Directors have put in place procedures to monitor and manage these risks.

Operational risk is relevant to every aspect of the Entity's business and covers a wide spectrum of issues. Losses arising from fraud, unauthorised activities, errors, omission, inefficiency, systems failure or from external events all fall within the definition of operational risk. The objective of the Entity's operational risk management is to manage and control operational risk in a cost effective manner within targeted levels of operational risk consistent with the Entity's risk appetite, as proposed by the Risk Management Committee set by the Board.

Top and Emerging Risks

Covid-19

The Covid-19 outbreak continues to dominate the political and economic landscape as it did throughout much of 2020. The twin shocks of a public health emergency and the resultant economic fallout have been felt around the world and hit both the advanced and emerging markets. The closure of borders threatened medical and food supplies for many markets and there is potential for countries and territories to focus efforts on building resilient supply chains closer to home to be less vulnerable to global shocks.

After an initial decrease in levels of Covid-19 in the third quarter of 2020, the UK Government returned to more stringent measures in the fourth quarter to tackle a second wave of Covid-19. The emergence of a new variant in the UK during December 2020, necessitated the introduction of a third national lockdown on 4 January 2021. However, the speed of the development of Covid-19 vaccines and the roll-out strategy for these in the UK has exceeded expectations, raising hopes of an exit strategy for the country from the pandemic later in 2021.

The uncertainty of Covid-19 and its effect on the UK economy has impacted the Entity's customers and performance, and the future effects of the pandemic are uncertain. Covid-19 has necessitated unprecedented levels of government response to protect public health, local economies and livelihoods. The risk of subsequent waves of infection remains.

Restrictions implemented by the UK Government to limit the spread of Covid-19 resulted in a sharp contraction in the UK economic activity in the first half of 2020. Economic activity recovered gradually in the second half of the year, but there is significant uncertainty associated with the pace and scale of resumption, with the UK unemployment rate expected to increase substantially in 2021 when the UK Government employment support measures come to an end. As a result, 2021 is expected to see a pronounced recession in the UK. The extent of economic activity, and any reduction in the UK unemployment rate in 2021, is contingent on successful containment of the virus and vaccination programmes and the resolution of other top risks facing the UK, including the impact of new trading terms in place between the UK and the EU from 1 January 2021.

The UK Government has deployed extensive measures to support households. Measures implemented include income support, while measures taken by the Bank of England include cuts to interest rates and support to funding markets. These measures are expected to be unwound gradually as government restrictions ease and as economic activity increases. The Bank of England is expected to maintain record-low interest rates for a considerable period of time and the debt burden of the UK Government is expected to rise significantly.

The Entity has initiated numerous measures to support our customers through these challenging times, including payment holidays and the waiving of certain fees and charges. The Entity's parent company (HSBC UK) is working closely with the UK Government and its supporting schemes that focus on the parts of the UK economy most impacted by Covid-19.

It is recognised that the above measures expose the Entity to heightened risks. The rapid introduction and varying nature of the UK Government support schemes, as well as customer expectations, can lead to risks as the Entity implements large scale changes in a short period of time. This has led to increased operational risks, including complex conduct considerations, increased reputational risk and increased risk of fraud. These risks are likely to be heightened further as and when the UK Government support schemes are unwound. We are focused upon avoiding and mitigating any conduct risks that may arise from the implementation decisions we have had to make and also those that may be created if our customers find themselves in financial difficulties as a result of Covid-19.

The Covid-19 outbreak has led to a weakening in UK GDP, a key input used for calculating ECL, and there remains the risk of more adverse economic scenarios given its ongoing impact. The impact will vary by sectors of the UK economy, with heightened risk to the retail, transport and discretionary consumer spending sectors being observed in the first stages of the outbreak. In addition, in times of crisis, fraudulent activity is often more prevalent, leading to potentially significant ECL charges. As a result of Covid-19, business continuity responses have been successfully implemented and the majority of our service level agreements have been maintained. We have not experienced any major impacts to the supply chain from our third-party service providers due to Covid-19. The risk of damage or theft to the Entity's physical assets or criminal injury to our employees remains unchanged and no significant incidents have impacted our buildings or staff.

Information Security and Cyber Crime

The Entity and other organisations continue to operate in an increasingly hostile cyber threat environment, which requires ongoing investment in business and technical controls to defend against these threats. Key threats include unauthorised access to online customers, advanced malware attacks and distributed denial of service attacks. We continually evaluate threat levels for the most prevalent attack types and their potential outcomes. To further protect the Entity and our customers we strengthened our controls to reduce the likelihood and impact of advanced malware, data leakage, infiltration of payment systems and denial of service attacks. We continued to enhance our cybersecurity capabilities, including threat detection and access control as well as back-up and recovery. An important part of our defence strategy is ensuring our people remain aware of cybersecurity issues and know how to report incidents.

IBOR Transition

Following the announcement by the FCA in July 2017 that it will no longer persuade or require banks to submit rates for Ibor after 2021, the UK market, along with the Bank of England Working Group on Sterling Risk-Free Reference Rates (RFR's) has been engaged with facilitating an orderly transition of the relevant Ibors to their replacement rates.

Internal funding is priced at RFR and no rate linked products are offered to customers. The Entity intends on transitioning the remaining small number of non customer assets and liabilities from Libor to RFR'S during 2021.

Financial Crime and Fraud Risk

Financial institutions remain under considerable regulatory scrutiny regarding their ability to prevent and detect financial crime. Financial crime threats continue to evolve, often in tandem with increased geopolitical developments, posing challenges for financial institutions to keep abreast of developments and manage conflicting laws. The global economic slowdown as a result of the Covid-19 outbreak is resulting in an increase in fraud risk, as fraudulent activity is often more prevalent in times of crisis. The evolving regulatory environment continues to present an execution challenge.

The Entity is strengthening and investing in fraud controls, to introduce next generation anti-fraud capabilities to protect both customers and the Entity.

Conduct and Customer Detriment

Financial institutions remain under considerable scrutiny regarding conduct of business, particularly in relation to fair outcomes for customers and orderly and transparent operations in financial markets. Regulators, prosecutors, the media and the public all have heightened expectations as to the behaviour and conduct of financial institutions, and any shortcomings or failure to demonstrate adequate controls are in place to mitigate such risks could result in regulatory sanctions, fines or an increase in civil litigation.

We have continued to enhance our management of conduct in areas including our governance of product arrangements, the treatment of potentially vulnerable customers, encouragement of a 'Speak Up' culture and management of related third party risks.

People Risk

Our people are critical to our success and it is important that we identify, manage and mitigate any risks that might have an impact on our colleagues feeling empowered and able to thrive in their careers, as well as being able to support our customers and the communities they serve. We aim to foster a culture that proactively promotes the right colleague behaviours and conduct and that we have the right number of people with the right skills, knowledge and capabilities to be able to do the right thing for customers.

We continue to increase our focus on resource planning and employee retention to ensure we mitigate any risks around capacity and capability, as well as equipping line managers with the skills to both manage change and support their colleagues to ensure we engender a strong positive culture.

We have processes in place to identify where behaviours and conduct give us cause for concern and can mitigate the risk accordingly. Our ultimate parent company HSBC Holdings plc (HSBC Group) leads the HSBC University, which is open to our people and is focused on the development of our colleagues and supporting our leaders to create an environment for success. This is critical to retaining high-calibre individuals with the values, skills and experience for current and future roles.

Data Management

The Entity uses a large number of systems and applications to support key business processes and operations. As a result, we often need to reconcile multiple data sources, including customer data sources, to reduce the risk of error. We, along with other organisations, also need to meet external/regulatory obligations such as the General Data Protection Regulation ('GDPR'), Basel Committee for Banking Supervision ('BCBS') 239 and Basel III. We are progressively improving data quality across a large number of systems. Our data management, aggregation and oversight continues to strengthen and enhance the effectiveness of internal systems and processes.

Climate Risk

Climate change can impact a number of our risk types, including:

- Transition Risk, arising from the move to a low-carbon economy through policy, regulatory and technological changes.
- Physical Risk, through increasing severity and/or frequency of severe weather events or other climatic events (e.g. sea level rise, flooding).

These have potential to cause both idiosyncratic and systemic risks resulting, over time, in potential financial impacts for the Entity. The awareness of climate risk, regulatory expectations and reputational risk have all heightened through 2020. The exposure we have to the risk has not materially heightened.

Process of UK Withdrawal from the European Union

The UK left the EU on 31 January 2020 and entered a transition period until 31 December 2020. During the transition period, the UK continued to be bound by EU laws and regulations. A Trade and Cooperation Agreement between the EU and the UK was agreed on 24 December 2020 and ratified on 30 December 2020. The deal mainly focused on goods and services, but also covered a wide range of other areas, including competition, state aid, tax, fishery, transport, data and security. However, it included limited elements on financial services.

The EU and UK agreed through a joint declaration to establish structured regulatory cooperation on financial services, with the aim of establishing a durable and stable relationship between autonomous jurisdictions. Based on a shared commitment to preserve financial stability, market integrity, and the protection of investors and consumers, these arrangements will allow for:

- bilateral exchanges of views and analysis relating to regulatory initiatives and other issues of interest;
- transparency and appropriate dialogue in the process of adoption, suspension and withdrawal of equivalence decisions; and
- enhanced cooperation and coordination including international bodies as appropriate.

Both parties will, by March 2021, agree a memorandum of understanding establishing the framework for this cooperation. The parties will discuss how to move forward on both sides with financial equivalence determinations between the EU and UK.

Section 172 statement

As set out in section 172 of the UK Companies Act 2006 (the 'Act'), the Directors must act in good faith to promote the success of the company for the benefit of its members as a whole. In performing their duty, under the Act, the Board is required to have full regard to, amongst other things: the interests of our colleagues; the impact of our operations on the community and environment; the need to foster the bank's business relationships with suppliers, customers and others; and the need to nurture our relationship with key stakeholders in order to maintain a reputation for high standards of business conduct and enhance the sustainable long term success of the business. The Directors give careful consideration to the factors set out above in discharging their duties.

The Directors are supported in the discharge of their duties by:

- An induction programme and ongoing training to provide an understanding of our business, financial performance and prospects;
- Management, who present proposals to the Board and Committee meetings for decision, include relevant information to enable them to determine the action that would most likely promote the success of the bank; and
- Agendas for the Board and Committee meetings are structured to provide sufficient time for the consideration and discussion of key matters.

Stakeholder Engagement

Building strong relationships with stakeholders helps enables the Entity to deliver the strategy in line with long term values and operate the business in a sustainable way. Stakeholders are the people who work for us, bank with us, own us, supply us and regulate us. Due to the nature of the relationship with them, Marks and Spencer plc are considered to be a key stakeholder in this regard.

The Covid-19 outbreak has created a great deal of uncertainty and disruption for the people and communities we serve and it is affecting everyone in different ways. The response is being tailored to the different circumstances and situations in which stakeholders find themselves in.

The Entity continues to evaluate our longer term strategy in light of Covid-19 and the low interest rate environment, considering the office footprint and supporting colleagues with a shift to a more location agnostic working model. The Entity is accelerating the roll-out of digital capabilities and functionality that helps customers to self-serve.

Employees

People continue to show great resilience despite the challenging environment. There has been a strong focus on managing the impacts of the Covid-19 crisis on our people's safety and wellbeing, including the transition to remote working at scale, to help colleagues remain safe and productive.

A structured communications approach uses leadership communications, campaigns and a regular flow of news to help colleagues to serve our customers better, make sense of our strategy, focus on our commercial priorities and provide clarity on issues. A sense of pride and purpose has been built by recognising colleagues' contributions to the Entity and celebrates achievements.

Understanding how colleagues feel is vital. It helps to ensure that the right support is given to fulfil their potential and do the right thing for customers. Colleagues are asked for feedback and encouraged to speak up. The views of a representative sample of our people are tested on a range of topics via our employee survey, 'Snapshot', which runs twice yearly. Snapshot results are presented to the Executive Committee, the Board, and other relevant committees of the functions. This ensures the attitudes and sentiments of people inform decision-making at all levels of the business and action can then be taken to tackle areas of concern. Additionally, the Entity participates in the external Banking Standards Board Annual Assessment, comprising an employee survey and focus groups where people can also have their say.

Feedback from 'Exchanges' is also an important way of listening to people; Exchange sessions are safe forum meetings, without agendas, attended by colleagues from across the organisation. They can discuss what matters to them, share views and suggest ideas, while managers and leaders attend to listen. Insight shows us that where our people participate in Exchange they are generally more positive about their experience with the Entity. They feel better able to speak up, are more trusting of managers and leaders, and report higher levels of wellbeing. The Entity provides the opportunity for people to take part in an Exchange meeting each quarter.

During the COVID-19 pandemic the Chief Executive Officer has maintained engagement of employees through weekly management calls, open staff forums, quarterly Connect sessions and updates on the M&S Bank intranet to keep the workforce up-to-date on business developments and answer submitted questions. The Board receives regular updates from the Chief Executive Officer on employee matters, including feedback received through our regular external and internal employee surveys such as the Banking Standards Board and Snapshot.

Suppliers

Suppliers provide critical support to the infrastructure and operations of the Entity. During the Covid-19 pandemic the Entity has continued to pay suppliers.

Customers

The Entity has actively supported customers through government schemes and non-government scheme lending, as well as providing flexibility in the existing products. Support measures include providing payment holidays on Mortgages, Personal Loans and Credit Cards along with increasing interest free overdrafts to £500. Digital technology roll-out has been accelerated to provide faster processing and enable more functionality to be accessed remotely.

Ensuring customer feedback is actioned and communicated back to our customers has remained a priority for us in 2020, particularly in light of the challenging conditions created by the pandemic. Dedicated members of staff have been focussed on contacting customers who either flag issues through our feedback mechanisms to ensure a resolution is found, or who are promoters of the business to thank them for their feedback and to learn from these positive experiences.

HSBC UK

A strong relationship is maintained with HSBC UK through cross-directorships of the Chairman of the Board and one of the non-executive Directors. Matters to escalate to HSBC UK remains a standing agenda item to ensure that all key issues are reported to our sole shareholder in a timely manner. In addition to this, the Head of Wealth and Private Banking (WPB) for HSBC UK was a member of the Board during the year and, since his resignation as a Director, continues to receive a standing invitation to all Board meetings to ensure key business decisions are aligned with the HSBC UK strategy.

As a wholly owned subsidiary, the Entity also benefits from certain engagement practices which take place at a HSBC Group level which allows us to have more efficient and effective engagement practices. For details on some of the engagement that takes place with stakeholders at a Group level, please see the HSBC Holdings plc 2020 Annual Report and HSBC Holdings plc Environmental, Social and Governance Update.

Marks and Spencer plc

The relationship with M&S plc is valued and appropriate steps are taken to ensure that they are kept up to date on key business activities and decisions. A committee comprising membership from Marks and Spencer Financial Services plc and M&S plc exists to oversee the Bank's business and ensure that this is carried out and in accordance with the principles in the Relationship Agreement. The Committee sets and monitors the strategy and ongoing development of the business.

Consideration of Stakeholders in Principal Decisions

The Board delegates authority for day-to-day management of the Entity to the executive team and engages management in setting, approving and overseeing execution of the Entity's strategy and related policies. Management conducts much of the Entity's primary engagement with both internal and external stakeholders, with the outputs of this engagement activity providing critical insight and perspective for the Board when taking decisions or challenging management in respect of decisions made on behalf of the Entity.

Depending on the nature of the issue in question the relevance of each stakeholder group may differ. Board decisions will not necessarily result in a positive outcome for all of our stakeholders, but by considering our purpose, vision and values, and having due regard for stakeholder relationships, the Board aims to ensure that its decisions promote the long term success of the Entity.

Events during 2020 required careful consideration of the needs and interests of the Entity's stakeholders. The Board oversaw management's response to the Covid-19 pandemic to mitigate the impact of the business, support customers and emerge from the crisis well-positioned for the future.

The Board and Management's top priority was the safety and well-being of employees whilst maintaining critical services for customers by providing support proactively, highlighting the support provided through government schemes and non-government scheme lending, as well as flexibility in our existing products. Furthermore, the Board needed to balance the need to support customers in the short term but remain mindful of the economic and unintended consequences of such changes in the medium and longer term. As the pandemic continued to spread, the Board monitored the impact of employees' mental and physical health through internal employee surveys and from discussions with senior management on the well-being of their teams. The Board also monitored management's mitigation of supplier resilience risk.

Phillip Scott

On behalf of the Board

P W Scott
Director

26 February 2021

Kings Meadow
Chester Business Park
Chester CH99 9FB

Report of the Directors

Directors

The Directors of the Entity who were in office during the year and up to the date of signing the financial statements were as follows:

Name	Appointed	Resigned
P M Spencer		
J Coyle		
S A Haire		18 June 2020
M Handley		25 May 2020
P W Scott		
D Stewart		13 May 2020
A D Van Den Aardweg		18 June 2020
D Lister		

During the year Stuart Haire, Matt Handley, Douglas Van Den Aardweg and David Stewart resigned as Directors.

The Articles of Association of the Entity provide that in certain circumstances the Directors are entitled to be indemnified out of the assets of the Entity against claims from third parties in respect of certain liabilities arising in connection with the performance of their functions, in accordance with the provisions of the UK Companies Act 2006. Indemnity provisions of this nature have been in place during the financial year but have not been utilised by the Directors. All Directors have the benefit of Directors' and officers' liability insurance.

Dividends

The Directors do not recommend the payment of an ordinary dividend in respect of the year ended 31 December 2020 (2019: £nil). Total distributions of £5.0m in respect of Additional Tier 1 capital were paid during 2020 (2019: £4.6m).

Significant events since the end of the financial year

No significant events affecting the Entity have occurred since the end of the financial year.

Future developments and Current Performance

The Entity's performance during the year is covered in the Strategic Report. The Entity will continue to support staff and customers during the pandemic whilst continuing to work with M&S plc on strategic initiatives.

Certain information that is required in the report of Directors under the Companies Act has been described in the Strategic Report on page 1.

Going concern basis

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Entity has the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows and capital resources. This includes the level of funding and capital support expected to be required and to be available from the HSBC Group. The Entity is part of the Domestic Liquidity Sub-group ('Liquidity Group') of HSBC UK Bank plc and therefore part of the internal liquidity control and management structure of HSBC UK Bank plc. The Entity's liquidity position is managed as part of the HSBC Bank UK plc Liquidity Group, under which members agree to provide liquidity support when necessary.

Financial Risk Management

The financial risk management objectives and policies of the Entity, together with an analysis of the exposure to such risks, as required under Part 1 of Schedule 7 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008, are set out in Note 26 of the Notes on the financial statements.

Diversity and inclusion

The Entity is committed to building a culture where individuals are valued, respected and supported; where different ideas, backgrounds, styles and perspectives are actively sought out to create business value; and where career advancement is based on objective criteria. Focus continues on the diversity profile of our workforce to help ensure it is reflective of the communities in which we operate and the customers we serve.

Diversity and Inclusion carries the highest level of executive support, and oversight of our diversity agenda and related activities resides with the Diversity and Inclusion Committee.

Employment of people with a disability

The Entity is committed to providing equal opportunities to employees. The employment of people with a disability is included in this commitment. The recruitment, training, career development and promotion of people with a disability are based on the aptitudes and abilities of the individual. Should employees become disabled during employment with us, efforts are made to continue their employment and, if necessary, appropriate training, reasonable equipment and facilities are provided.

Employment policy

The Entity continues to regard communication with its employees as a key aspect of its policies. Information is given to employees about employment matters and about the financial and economic factors affecting the Entity's performance through management channels, oral communication and by way of attendance at internal seminars and training programmes. Employees are encouraged to discuss operational and strategic issues with their line management and to make suggestions aimed at improving performance. The involvement of employees in the performance of the Entity is further encouraged through a profit participation scheme.

Capital management

The Entity defines capital as total shareholder's equity. It is the Entity's objective to maintain a strong capital base to support the business strategy and to meet regulatory capital requirements at all times. The PRA as the regulator of the Entity, sets capital requirements and receives information on the capital adequacy of the Entity. The Entity complied with the PRA's capital adequacy requirements throughout 2020.

The Entity's policy and practice in capital measurement and allocation is underpinned by the Capital Requirements Regulation (CRR) and Capital Requirements Directive ('CRD IV') rules and any national discretions applied by the PRA. CRD IV legislation implemented Basel III in the EU, and in the UK, the 'PRA Rulebook' for CRR firms transposed the various discretions under CRD IV legislation into UK requirements. The Basel III framework is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline. Basel III also includes a number of capital buffers, including the Capital Conservation Buffer ('CCB'), Countercyclical Capital Buffer ('CCyB'), and other systemic buffers such as the Global/Other Systemically Important Institutions ('G-SII'/'O-SII') buffer.

Pillar 3 of the Basel regulatory framework is related to market discipline and aims to make firms more transparent by requiring them to publish specific details of their risks and capital, and how these are managed. Separate Pillar 3 disclosures are not required for the Entity as the Entity is included in the consolidated Pillar 3 disclosures of HSBC UK Bank plc. These disclosures are published as a separate document on HSBC UK Bank plc's website.

Regulatory capital (audited)

The Entity's capital base is divided into three main categories namely common equity tier 1, additional tier 1 and tier 2, depending on the degree of permanency and loss absorbency exhibited.

- Common equity tier 1 capital is the highest quality form of capital, comprising shareholders' equity adjusted for various regulatory deductions. These include deductions of the excess of expected loss amounts calculated under the Internal Ratings Based ('IRB') approach using the firm's own data, over and above the equivalent accounting provision and intangible assets and an IFRS 9 transitional add-back adjustment.
- Additional tier 1 capital comprises non-common equity capital securities which by nature of their terms are eligible for inclusion in the firm's capital base under CRD IV rules.
- Tier 2 comprises subordinated loans and any excess of accounting provision over equivalent IRB expected loss, subject to a cap of 0.6% of risk weighted assets.

Calculation of actual capital

	2020	2019
	£'000	£'000
Tier 1 capital		
Shareholders' equity[1]	**316,421**	348,708
Deductions		
- Adjustment for intangible assets	**(773)**	(1,491)
- IFRS 9 transitional add-back	**99,717**	23,227
Common equity tier 1 capital	**415,365**	370,444
Issue of additional tier 1 instrument (note 23)	**69,000**	69,000
Tier 1 capital	**484,365**	**439,444**
Tier 2 capital		
Total qualifying tier 2 capital before deductions		
- Collective impairment allowances	**11,413**	3,663
- Term subordinated debt (note 21)	**95,000**	95,000
Tier 2 capital	**106,413**	98,663
Total regulatory capital	**590,778**	538,107
Risk-weighted assets (Unaudited)		
Credit and counterparty risk	**2,210,801**	2,531,342
Operational risk	**466,132**	493,850
Total	**2,676,933**	3,025,192
Capital ratios (%) (Unaudited)		
Common equity tier 1 ratio	**15.52**	12.25
Tier 1 ratio	**18.09**	14.53
Total capital ratio (Unaudited)	**22.07**	17.79

[1] *Includes reported loss for 2020*

Corporate Governance Statement

The Entity is, together with the wider HSBC Group, committed to high standards of corporate governance and applies the applicable HSBC Group's suite of corporate governance policies, frameworks and procedures. It also complies with its relevant legal and regulatory governance requirements, including but not limited to rules set out in the PRA Rulebook for Ring-Fenced Bodies. As such, the Entity and its Board consider compliance with its requirements as a UK financial services firm, ring-fenced bank and subsidiary within the HSBC Group to be comprehensive and robust and have therefore chosen not to adopt a corporate governance code, such as the FRC Corporate Governance Code or Wates Corporate Governance Principles.

During the year ended 31 December 2020 and to the date of this report, the Entity has complied with all of HSBC's corporate governance policies, frameworks and procedures that apply and also with its legal and regulatory corporate governance obligations.

How the Directors have Regard to Key Stakeholders and Employees

As described on page 5, the Board considers feedback from engagement exercises with employees and key stakeholders throughout the year. It also has regard to the interest of these stakeholders when considering and approving the Entity's annual operating plan, risk appetite statement, and capital and operating plans, through robust challenge of management's proposals and plans to achieve the Company's strategic objectives, financial targets and key performance indicators. Further details on how the Directors have engaged with employees and had regard to their interests and the need to foster the company's business relationships when making decisions can be found on page 5.

Independent auditors

PricewaterhouseCoopers LLP ('PwC') are the external auditors to Entity. PwC has expressed its willingness to continue in office and the Board recommends that PwC be re-appointed as the Entity's auditors.

Directors' responsibility statement

The following statement, which should be read in conjunction with the auditor's statement of their responsibilities set out in their report on the next page, is made with a view to distinguish the respective responsibilities of the Directors and of the auditors in relation to the financial statements.

The Directors are responsible for preparing the *Annual Report and Financial Statements*, in accordance with applicable law and regulation.

Company law requires the Directors to prepare Financial Statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union ('EU').

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Entity and of the profit or loss of the Entity for that period.

In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRS, as adopted by the EU have been followed, subject to any material departure disclosed and explained in the financial statements;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Entity will continue in business.

The Directors are also responsible for safeguarding the assets of the Entity and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Entity's transactions and disclose with reasonable accuracy at any time the financial position of the Entity and enable them to ensure that the financial statements comply with the Companies Act 2006.

The Directors are responsible for the maintenance and integrity of the Entity's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' Confirmations

The Directors consider that the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Entity's position and performance, business model and strategy.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the Entity and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for safeguarding the assets of the Entity and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Disclosure of Information to Auditors

In accordance with section 418 of the Companies Act 2006, the Report of the Directors includes a statement, in the case of each Director in office as at the date the Report of the Directors is approved, that:

- so far as the Director is aware, there is no relevant audit information of which the Entity's auditors are unaware; and
- they have taken all the steps they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Entity's auditors are aware of that information.

On behalf of the Board

Phillip Scott

P W Scott
Director
26 February 2021

Kings Meadow
Chester Business Park
Chester CH99 9FB

Independent auditors' report to the members of Marks and Spencer Financial Services Plc

Report on the audit of the financial statements

Opinion

In our opinion, Marks and Spencer Financial Services Plc's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2020 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the " Annual Report "), which comprise: the balance sheet as at 31 December 2020; the income statement, the statement of comprehensive income, the statement of cash flows, the statement of changes in equity for the year then ended; and the notes on the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Board of Directors.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the group headed by HSBC Holdings Plc, of which the company is a member.

Other than those disclosed in note 7 to the financial statements, we have provided no non-audit services to the company in the period from 1 January 2020 to 31 December 2020.

Our audit approach

Overview

Audit scope

- The majority of the accounting and financial reporting function is based at the company's principal office in Chester. The company's ultimate parent is HSBC Holdings plc. Certain control activities and processes are performed by other operating companies within the HSBC Group and some at shared service centres (for example, payroll processing). Therefore, certain audit procedures were performed by PwC teams in the relevant locations. This work was summarised in a Memorandum of Work Performed. We reviewed the Memorandum of Work Performed, and determined that the procedures performed were appropriate and therefore concluded that we could place reliance on the work performed by other PwC teams.

Key audit matters

- Expected credit loss ("ECL") provision for loans and advances to customers
- Customer Redress - Payment Protection Insurance ('PPI')
- Provision for conduct related matters other than PPI
- Recognition of interest income under Effective Interest Rate accounting
- Information Technology ('IT') Access Management
- Impact of Coronavirus disease (COVID-19)

Materiality

- Overall materiality: £4 million (2019: £5 million) based on 3 year average of 5% of adjusted profit before tax.
- Performance materiality: £3 million.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

Capability of the audit in detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined in the Auditors' responsibilities for the audit of the financial statements section, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to the Financial Conduct Authority's regulations, the Prudential Regulation Authority's regulations and the UK tax legislation, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries to increase revenue or reduce expenditure, and management bias in accounting estimates.

Our audit procedures included challenging assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the expected credit loss provisions of loans and advances to customers, EIR accounting, provisioning for PPI and other conduct related matters (see related key audit matters), and identifying and testing journal entries, in particular any journal entries posted in line with certain fraud risk-based criteria. Audit procedures performed by the engagement team included review of the financial statement disclosures to underlying supporting documentation, review of correspondence with and reports to the regulators, review of correspondence with legal advisors, enquiries of management, enquiries of legal counsel and review of internal audit reports in so far as they related to the financial statements.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

This is not a complete list of all risks identified by our audit.

The Impact of Coronavirus disease (COVID-19) is a new key audit matter this year. Otherwise, the key audit matters are consistent with last year. The key audit matters are discussed further in the Appendix.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

At the planning stage we updated our understanding of the entity and its environment, considering the company's operations, ownership and governance structures, accounting framework, selection of accounting policies and the company's objectives and strategies. We updated our understanding of the internal control environment, including in relation to IT. Industry level factors were also considered, including applicable laws and regulations.

Based on these initial audit planning procedures, we performed our risk assessment at the account balance and assertion level, considering risks of material misstatement through fraud or error.

The scope of our audit and the nature, timing and extent of our audit procedures were designed, planned and executed with consideration of our risk assessment, the financial significance of account balances, and other qualitative factors (e.g. history of error or misstatements). We performed audit procedures over all account balances and disclosures which we considered to be material and/or represent a risk of material misstatement to the financial statements.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows :

Overall company materiality	£4 million (2019: £5 million).
How we determined it	3 year average of 5% of adjusted profit before tax
Rationale for benchmark applied	Adjusted profit before tax is the primary measure used by the company and the shareholder in assessing the performance of the company and removes the impact of significant items that distort the underlying results. Costs relating to customer redress programmes (such as PPI and other conduct related matters) are large, one-off items unrelated to the underlying performance of the company. The impact of the profit share is also adjusted. We then took a three year average of historic adjusted profit before tax due to the impact of COVID-19 on the company's performance for the year ended 31 December 2020.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £3 million for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the Board of Directors that we would report to them misstatements identified during our audit above £200,000 (2019: £250,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- Performed a risk assessment to identify factors that could impact the going concern basis of accounting, including the impact of Covid-19 on the financial and operating performance of the company.
- Understanding and evaluating the company's financial forecasts and the company's stress testing of liquidity and regulatory capital, including the severity of the stress scenarios that were used.
- Reading and evaluating the adequacy of the disclosures made in the financial statements in relation to going concern.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

However, because not all future events or conditions can be predicted, this conclusion is not a guarantee as to the company's ability to continue as a going concern.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on our work undertaken in the course of the audit, the Companies Act 2006 requires us also to report certain opinions and matters as described below.

Strategic report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Report of the Directors for the year ended 31 December 2020 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Report of the Directors.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Directors' Responsibility Statement, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not obtained all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Board of Directors, we were appointed by the directors on 17 May 2015 to audit the financial statements for the year ended 31 December 2015 and subsequent financial periods. The period of total uninterrupted engagement is 6 years, covering the years ended 31 December 2015 to 31 December 2020.

Chris Shepherd.

Chris Shepherd (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Manchester
26 February 2021

Appendix: Key audit matters discussed with the Audit Committee

The key audit matters are discussed below together with an explanation of how the audit was tailored to address these specific areas.

Expected credit loss ("ECL") provision for loans and advances to customers

Nature of key audit matter	Matters discussed with the Board of Directors
Determining expected credit losses (ECL) involves management judgement and is subject to a high degree of estimation uncertainty, both of which have significantly increased as a result of COVID-19. Management makes various assumptions when estimating ECL. The significant assumptions that we focus on in our audit included those with greater levels of management judgement and for which variations had the most significant impact on ECL. Specifically these included: • Forward looking economic scenarios and their likelihoods; and • The probability of defaults and significant increase in credit risk criteria. The modelling methodologies that use these assumptions, as well as other data, to estimate ECL are complex and not standardised. The modelling methodologies are developed using historical experience, which can result in limitations in their reliability to appropriately estimate ECL. These limitations are often addressed with adjustments, which are inherently judgemental and subject to estimation uncertainty. The impact of the COVID-19 pandemic has resulted in unprecedented economic conditions that vary across industry sectors. COVID-19 related government support programmes and regulatory interventions have impacted economic factors such as GDP and unemployment, and consequently the extent and timing of customer defaults. These factors have increased the uncertainty around judgements made in determining the severity and likelihood of macroeconomic variable (MEV) forecasts across the different economic scenarios used in ECL models. Furthermore, modelled outcomes are based on historical relationships, and as such generate overly sensitive ECL outcomes in conditions outside the range of historical experience. Management has made significant adjustments to ECL to address these limitations through management judgemental adjustments to modelled outcomes. The nature and extent of these limitations and the resulting changes to ECL varies across the loan portfolios.	We held discussions covering governance and controls over ECL, with a significant focus on the impact of COVID-19. We also discussed a number of other areas, including: • The severity and likelihood of MEV forecasts in economics scenarios, reflecting the impact of COVID-19; • The identification and assessment of model limitations and resulting changes and adjustments to ECL, in particular for approaches adopted in response to COVID-19; • Models that had parameter refreshes during the year; • The disclosures made to explain ECL, in particular the impact of COVID-19 on determining ECL and the resulting estimation uncertainty.

Procedures performed to support our discussions and conclusions

In conjunction with the ultimate and immediate parents audit teams, we assessed the design of governance and controls over the estimation of ECLs, as well as testing how effectively they operated. We observed management's review and challenge governance forums for (1) the determination of MEV forecasts and their likelihood for different economic scenarios, and (2) the assessment of ECL, including the assessment of model limitations and approval of any resulting adjustments to modelled outcomes based on management's judgements.

We collectively tested controls over:

- Model validation and monitoring;
- The input of critical data into source systems and the flow and transformation of critical data between source systems to the impairment models; and
- The calculation and approval of management judgemental adjustments to modelled outcomes.

We involved our economic experts in assessing the reasonableness of the severity and likelihood of MEV forecasts. These assessments considered the sensitivity of ECLs to variations in the severity and likelihood of MEVs for different economic scenarios.

We involved our modelling experts in assessing the appropriateness of material model changes and performing a review of the methodology and assessment of key assumptions using client data to re-create the assumptions where necessary. For the material ECL models, we independently re-performed the modelling for certain aspects of the ECL calculation. We also assessed the appropriateness of modelling methodologies that did not change during the year, giving specific consideration to COVID-19 and whether adjustments were needed. In addition, we performed testing over:

- The compliance of ECL methodologies and assumptions with the requirements of IFRS9; and
- A sample of critical data used in the year end ECL calculation and to estimate management judgemental adjustments.

We evaluated and tested the Credit Risk disclosure within note 26 made in the Annual Report and Financial Statements 2020.

Relevant references in the Annual Report and Financial Statements 2020

Note 1.2: Summary of significant accounting policies (c) Financial instruments measured at amortised cost, page 25.
Summary of credit risk, page 43.
Measurement uncertainty and sensitivity analysis of ECL estimates, page 46.

Customer Redress - Payment Protection Insurance ('PPI')

Nature of key audit matter	Matters discussed with the Board of Directors
Since the timebar passed on 29 August 2019, the provision related to PPI is mainly for the legal complaints and the Official Receiver complaints. For the Official Receiver related complaints, a settlement has been reached as such the judgement related to this part of the provision has reduced. Our work focussed on the legal complaints component of the provision and the key assumptions related to complaints volumes and the cost of redress.	We discussed the adequacy of provisions for legal complaints and the Official Receiver settlement. We discussed the results of our controls and substantive testing related to the provision for legal complaints.

Procedures performed to support our discussions and conclusions

- Evaluated the design and tested the operating effectiveness of key controls over the process of capturing key data used in the PPI provision model and the model calculation.
- Tested the historical data used in the model and model calculation relating to the projected number of legal complaints inflow, average settlement rate and average settlement amount.
- Tested the evidence supporting the agreed settlement with the Official Receiver and related provision.
- For all the key judgements and assumptions applied to the provision, we assessed the appropriateness and considered the sensitivity of the provision to changes in various assumptions. This could result in different amounts for some provisions to those calculated; however these differences were within a reasonable range of outcomes.
- Evaluated whether the disclosures within the financial statements appropriately address the significant uncertainties that exist around determining the provisions and the sensitivity of the provisions to changes in the underlying estimates by comparing to the output of our audit work.

Relevant references in the Annual Report and Financial Statements 2020

Note 1.2: Summary of significant accounting policies (a) Provisions, page 25.
Note 20: Provisions, page 39.

Provision for conduct related matters other than PPI

Nature of key audit matter	Matters discussed with the Board of Directors
A number of deficiencies have been identified in the Bank's internal processes that have resulted in customer detriment. *The provision for these matters reflects the expected cost of* repayment of historic fees and interest, distress and inconvenience payments and related operational remediation activities. Management grouped customers into cohorts based on the nature of the matter. Customer redress payments have been made to date for most of the cohorts, with the year end provision primarily related to one specific cohort. For this specific cohort of customers, the key assumption is in relation to the identification of inscope customers, which is where we focussed our testing procedures. We also considered assumptions related to the overall redress amount.	We discussed with the Board of Directors the process performed by management to estimate the impacted populations for the main cohort outstanding at year end. We also *discussed the assumptions used in determining the expected redress for the cohort.* We discussed the results of our controls and substantive testing. We also discussed alternative scenarios and the range of sensitivity in concluding on the adequacy of the provision held.

Procedures performed to support our discussions and conclusions

- Evaluated the design and tested the operating effectiveness of key controls over key inputs to the calculated provision.
- Evaluated the completeness of impacted cohorts identified by management by comparing these to customer populations expected to be affected by process deficiencies.
- Examined the appropriateness of the provisioning model and underlying estimates used. Tested the appropriateness of customer populations identified for the cohorts and the estimated redress per customer.
- Tested the accuracy of the model calculations and considered the sensitivity of the provision to possible changes in outcome.
- Observed management's review and challenge forums to assess the appropriateness of the provision.
- Perform inquiry with the Skilled Person regarding the project progress, key areas of focus and issues identified to date.
- Evaluated whether the disclosures within the financial statements appropriately address the uncertainties inherent to determining the provision and the sensitivity of the provision to changes in key assumptions.

Relevant references in the Annual Report and Financial Statements 2020

Note 1.2: Summary of significant accounting policies (a) Provisions, page 25.
Note 20: Provisions, page 39.

Recognition of interest income under Effective Interest Rate accounting

Nature of key audit matter	Matters discussed with the Board of Directors
Loans and advances are recognised at amortised cost, with the associated interest income recognised using the Effective Interest Rate (EIR) method. The majority of interest income is automatically calculated by the loan administration systems and requires no management intervention or judgement. EIR accounting requires management to recognise income and expenses directly related to a loan over its expected life The most significant area where EIR accounting is applied is in relation to credit cards, where interest income is required to be recognised over the period that a customer is expected to have the credit card, including interest free promotional periods, which results in an EIR asset being recognised. The most significant inputs to the calculation where management uses judgement are the performance of historic credit card portfolios to estimate customer spending levels, the total interest yield expected to be earned, and the expected period that customers will use their credit cards. Changes in these assumptions could have a material impact on the EIR adjustments and hence the interest income recognised. The COVID-19 pandemic has impacted the way that customers have used their credit cards, for example lower spending levels during 2020 given lockdowns. Management have incorporated the changes in customer behaviour and updated their assumptions related to future customer spend levels	Discussions with the Board of Directors focused on the key judgements and assumptions including the level of expected customer balances and interest yields during the promotional offers, the retention of balances after the end of the promotional period and consideration as to how historic experience is consistent with that expected in the future We discussed the impact on key areas of judgements applied in response to the COVID-19 outbreak, including the impact on customer behaviour and future projections of spending levels. We also discussed the results of our audit work including testing of management controls and substantive testing.

Procedures performed to support our discussions and conclusions

- Tested the controls over data input and checked the accuracy of model calculations.
- Observed management's governance meetings for the setting, challenge and approval of key assumptions, including monitoring of actual trends compared to forecast estimates.
- Tested the appropriateness of models used by management in EIR calculations, and critically assessed and challenged the appropriateness of the key assumptions, including expected life of customer accounts and assessing whether the use of customer balance and yield curves based on historic data were appropriately reflective of current behaviour and an appropriate indicator of the future.
- Performed sensitivity analyses of key assumptions to understand the materiality of the impact that potential realistic changes in assumptions may have, either individually or in combination, on the EIR asset.
- Performed testing over the reasonableness of adjustments related to COVID-19, and the impact on customer behaviour.
- Assessed the sufficiency of the disclosures in the financial statements relating to significant assumptions made in the EIR calculation, including disclosure of sensitivities.

Relevant references in the Annual Report and Financial Statements 2020

Note 1.2: Summary of significant accounting policies (b) Income and expense, page 25.
Note 13: Loans and advances to customers, page 36.

Information Technology ('IT') Access Management

Nature of key audit matter	Matters discussed with the Board of Directors
The company's technology is reliant on HSBC Group's technology infrastructure. The environment is large and complex. The company's financial reporting processes rely upon a significant element of the IT environment, both within Finance and the business and operations more broadly Access management controls are an important part of the IT environment to ensure both access and changes made to systems and data are appropriate. Our audit approach relies extensively on the effectiveness of IT access management. As part of our audit work in prior periods, we identified control deficiencies in relation to IT access management for systems and data relevant to financial reporting. Management has an ongoing remediation programme to address these matters.	The significance of IT access management to our audit was discussed at the Board meetings during the year, as well as progress on the remediation programme, control deficiencies identified and related audit responses.

Procedures performed to support our discussions and conclusions

IT access management controls were tested for systems and data relevant to financial reporting that we relied upon as part of our audit. Specifically we tested controls over:

- Authorising new access requests;
- The timely removal of access rights;
- Periodic monitoring of the appropriateness of access rights to systems and data;
- Restricting highly privileged access to appropriate personnel;
- The accuracy of information about IT users to facilitate access management;
- Segregation of access across IT and business functions;
- Changes made to systems and data; and
- Understanding and assessing reliance on third parties, including Service Organisation controls reports.

We also independently assessed password policies and system configurations, and performed substantive audit procedures in relation to access right removal, privileged access, IT user information and segregation of duties.
We performed further testing where control deficiencies were identified, including:

- Where inappropriate access was identified, we understood and assessed the nature of the access, and where possible, obtained additional evidence on the appropriateness of activities performed; and,
- Where necessary, identified and tested compensating business controls and performed other audit procedures that addressed the risk that inappropriate changes were made to systems and data.

Relevant references in the Annual Report and Financial Statements 2020

Strategic Report: Top and Emerging Risks, page 3.

Impact of Coronavirus disease (COVID-19)

Nature of key audit matter	Matters discussed with the Board of Directors
The impact of the COVID-19 pandemic has resulted in unprecedented economic conditions and resulting government support programmes and regulatory interventions to support businesses and people. The COVID-19 pandemic has also changed the way that companies operate their businesses, with one of most substantial impacts being the transition to remote working. A substantial proportion of M&S Bank's employees worked remotely during 2020, with some consequential changes on their processes and the control environment, some of which were relevant for financial reporting purposes. Our audit team also worked remotely for most of 2020. The impact of the COVID-19 pandemic and resulting uncertainty has impacted a number of the estimates in the financial statements. The impact on the most significant accounting judgements and our audit is set out in the 'Expected credit loss ('ECL') provision for loans and advances' key audit matter in this report. We have also discussed the impact of the COVID-19 pandemic in our conclusions relating to going concern.	We discussed our assessment of the impact of COVID-19 on M&S Bank's operations and control environment with the Board of Directors. We also explained how we planned to execute our audit with substantially all of our audit team working remotely.

Procedures performed to support our discussions and conclusions

We engaged with the Board and management at M&S Bank in a manner consistent with our previous audits, albeit remotely using video and telephone calls. Substantially all of the information and audit evidence we needed for the M&S Bank audit was provided in electronic format. We shared information, including the audit evidence provided to us by M&S Bank, using share-screen functionality in video calls and our secure encrypted information sharing software.

We understood and assessed the transition of M&S Bank employees to working remotely on the control environment relevant to financial reporting, and reflected this in our audit approach for new or changed processes and controls.
Where M&S Bank undertook new business activities as a result of COVID-19, for example, the government sponsored lending programmes, we assessed the audit risks and designed appropriate audit procedures.

Relevant references in the Annual Report and Financial Statements 2020

Strategic Report: Top and Emerging Risks, page 3.

Financial statements

Income statement for the year ended 31 December 2020

	Notes	2020 £'000	2019 £'000
Interest income		**197,750**	252,503
Interest expense		**(32,532)**	(47,638)
Net interest income	2	**165,218**	204,865
Fee and commission income		**64,207**	105,463
Fee and commission expense		**(27,909)**	(35,686)
Net fee income	2	**36,298**	69,777
Gains less losses from financial investments		**426**	53
Other operating Income	3	**33,331**	66,265
Net operating income before change in expected credit losses and other credit impairment charges		**234,847**	340,960
Change in expected credit losses and other credit impairment charges	2	**(155,851)**	(70,289)
Net operating income		**78,996**	270,671
Employee compensation and benefits	4	**(44,481)**	(45,865)
General and administrative expenses	2	**(65,727)**	(305,682)
Depreciation of property, plant and equipment	14	**(629)**	(737)
Amortisation of intangible assets	15	**(529)**	(330)
Depreciation of right-of-use assets	25	**(3,289)**	(3,958)
Total operating expenses		**(114,655)**	(356,572)
Operating loss		**(35,659)**	(85,901)
Loss before tax		**(35,659)**	(85,901)
Tax credit/(expense)	8	**8,374**	(32,659)
Loss for the year		**(27,285)**	(118,560)

Statement of comprehensive income for the year ended 31 December 2020

	2020 £'000	2019 £'000
Loss for the year	**(27,285)**	(118,560)
Total comprehensive expense for the year	**(27,285)**	(118,560)

All operations are continuing. There has been no comprehensive income or expense other than the loss for the year as shown above (2019: nil).

Balance sheet at 31 December 2020
Registered No: 1772585

	Notes	2020 £'000	2019 £'000
Assets			
Cash and balances at central banks		**10,365**	9,361
Items in the course of collection from other banks		**9,267**	7,704
Loans and advances to banks	*12*	**1,613,658**	1,700,247
Loans and advances to customers	*13*	**3,239,177**	4,138,465
Prepayments and accrued income		**2,872**	3,858
Other assets	*16*	**169,910**	135,602
Current tax assets		**10,791**	–
Property, plant and equipment	*14*	**1,480**	1,546
Right-of-use assets	*25*	**17,380**	19,201
Intangible assets	*15*	**1,007**	1,491
Deferred tax assets	*9*	**12,207**	12,528
Total assets		**5,088,114**	6,030,003
Liabilities and equity			
Liabilities			
Deposits by banks	*17*	**2,260,034**	3,055,000
Customer accounts	*18*	**2,178,589**	2,123,314
Items in the course of transmission to other banks		**3,275**	6,589
Accruals, deferred income and other liabilities	*19*	**72,629**	105,617
Current tax liabilities		**–**	31,066
Provisions	*20*	**92,361**	195,507
Subordinated liabilities	*21*	**95,164**	95,202
Total liabilities		**4,702,052**	5,612,295
Equity			
Called up share capital	*23*	**260,000**	260,000
Other equity instruments	*23*	**69,000**	69,000
Retained earnings		**57,062**	88,708
Total equity		**386,062**	417,708
Total liabilities and equity		**5,088,114**	6,030,003

The accompanying notes on pages 24 to 62 form an integral part of these financial statements.

These financial statements were approved by the Board of Directors on 26 February 2021 and signed on its behalf by:

Phillip Scott

P W Scott
Director

Statement of cash flows for the year ended 31 December 2020

	Notes	2020 £'000	2019 £'000
Cash flows from operating activities			
Loss before tax		**(35,659)**	(85,901)
Adjustments for:			
Non-cash items included in loss before tax	10	**13,548**	132,426
Change in operating assets	10	**313,721**	(435,396)
Change in operating liabilities	10	**22,406**	(151,246)
Tax income		**(33,160)**	(23,749)
Net cash generated from/(used in) operating activities		**280,856**	(563,866)
Cash flows from investing activities			
Purchase of property, plant and equipment		**(563)**	(682)
Purchase of intangible assets		**(993)**	(276)
Net cash used in investing activities		**(1,556)**	(958)
Cash flows from financing activities			
Proceeds from Borrowings		**(720,005)**	225,595
Issue of ordinary share capital and other equity instruments	23	**–**	176,000
Subordinated loan capital issued	21	**–**	16,000
Distribution on other equity instruments (AT1)		**(5,003)**	(4,559)
Net cash (used in)/generated from financing activities		**(725,008)**	413,036
Net decrease in cash and cash equivalents		**(445,708)**	(151,788)
Cash and cash equivalents brought forward [1]		**1,245,723**	1,397,511
Cash and cash equivalents carried forward [1]	10	**800,015**	1,245,723

1. At 31 December 2020 £4.1m (2019: £5.4m) was not available for use by the Entity as it relates to mandatory deposits at central banks.

Statement of changes in equity for the year ended 31 December 2020

	Called up share capital £'000	Other equity instruments £'000	Retained earnings £'000	Total equity £'000
At 1 Jan 2020	**260,000**	**69,000**	**88,708**	**417,708**
Loss for the year	–	–	(27,285)	(27,285)
Distribution on other equity instruments (AT1)	–	–	(5,003)	(5,003)
Net impact of equity-settled share-based payments	–	–	641	641
At 31 Dec 2020	**260,000**	**69,000**	**57,061**	**386,061**

	Called up share capital £'000	Other equity instruments £'000	Retained earnings £'000	Total equity £'000
At 1 Jan 2019	93,000	60,000	211,446	364,446
Loss for the year	–	–	(118,560)	(118,560)
Additional tier 1 instrument issued	–	9,000	–	9,000
New shares issued	167,000	–	–	167,000
Distribution on other equity instruments (AT1)	–	–	(4,559)	(4,559)
Net impact of equity-settled share-based payments	–	–	381	381
At 31 Dec 2019	260,000	69,000	88,708	417,708

Equity is wholly attributable to equity shareholders of Marks and Spencer Financial Services Plc.

Notes on the financial statements

1. Basis of preparation and significant accounting policies

1.1. Basis of preparation

(a) Compliance with International Financial Reporting Standards

The financial statements of the Entity comply with international accounting standards in conformity with the requirements of the Companies Act 2006. These financial statements are also prepared in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB'), including interpretations issued by the IFRS Interpretations Committee, as there are no applicable differences from IFRSs as issued by the IASB for the periods presented.

(b) Future accounting developments

Minor amendments to IFRSs

The IASB has not published any minor amendments effective from 1 January 2021 that are applicable to the entity. However, the IASB has published a number of minor amendments to IFRSs that are effective from 1 January 2022 and 1 January 2023. The Entity expects they will have an insignificant effect, when adopted, on the financial statements of the Entity.

New IFRSs

IFRS 17 'Insurance Contracts'

The IASB has published IFRS 17 'Insurance Contracts'. IFRS 17 has not yet been endorsed but is not expected to have a significant impact on the financial statements of the Entity.

(c) Presentation of information

The functional currency of the Entity is Sterling, which is also the presentational currency of the financial statements of the Entity.

Certain disclosures required by IFRSs have been included in the audited sections of this Annual Report and Financial Statements 2020 as follows:

• disclosures concerning the nature and extent of risks relating to financial instruments are included in the 'Management of Risk note'; and

• capital disclosures are included in the 'Report of the Directors: Capital Management' on Page 8.

(d) Critical accounting estimates and judgements

The preparation of financial information requires the use of estimates and judgements about future conditions. In view of the inherent uncertainties and the high level of subjectivity involved in the recognition or measurement of items, highlighted as the 'critical accounting estimates and judgements' in section 1.2 to follow, it is possible that the outcomes in the next financial year and beyond could differ from those on which management's estimates are based. This could result in materially different conclusions from those reached by management for the purposes of these financial statements. Management's selection of the Entity's accounting policies that contain critical estimates and judgements reflects the materiality of the items to which the policies are applied and the high degree of judgement and estimation uncertainty involved.

(e) Going concern

The financial statements are prepared on a going concern basis, as the Directors are satisfied that the Entity has the resources to continue in business for the foreseeable future. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including future projections of profitability, cash flows, capital requirements and capital resources. These considerations include stressed scenarios that reflect the increasing uncertainty that the global Covid-19 pandemic has had on the Entity's operations, as well as considering potential impacts from other top and emerging risks, and the related impact on profitability, capital and liquidity.

1.2. Summary of significant accounting policies

(a) Provisions, contingent liabilities and guarantees

Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a present legal or constructive obligation that has arisen as a result of past events and for which a reliable estimate can be made.

Critical accounting estimates and judgements

The recognition and measurement of provisions requires the Entity to make a number of judgements, assumptions and estimates. The most significant are set out below:

Judgements	Estimates
• Provisions for legal proceedings and regulatory matters typically require a higher degree of judgement than other types of provisions. When matters are at an early stage, accounting judgements can be difficult because of the high degree of uncertainty associated with determining whether a present obligation exists, and estimating the probability and amount of any outflows that may arise. As matters progress, management and legal advisers evaluate on an ongoing basis whether provisions should be recognised, revising previous estimates as appropriate. At more advanced stages, it is typically easier to make estimates around a better defined set of possible outcomes. • Determining whether a present obligation exists. Professional advice is taken on the assessment of litigation, property (including onerous contracts) and similar obligations.	• Provisions for customer remediation also require significant levels of estimation. The amounts of provisions recognised depend on a number of different assumptions, such as the conversion of inbound contact and information requests into new complaints, the proportion of those new complaints which are to be upheld, and the redress to be paid to each upheld complaint. More information about these assumptions is included in Note 20. • Provisions for legal proceedings and regulatory matters remain very sensitive to the assumptions used in the estimate. There could be a wider range of possible outcomes for any pending legal proceedings, investigations or inquiries. As a result it is often not practicable to quantify a range of possible outcomes for individual matters. It is also not practicable to meaningfully quantify ranges of potential outcomes in aggregate for these types of provisions because of the diverse nature and circumstances of such matters and the wide range of uncertainties involved.

Contingent liabilities, contractual commitments and guarantees

Contingent liabilities

Contingent liabilities related to legal proceedings or regulatory matters are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.

Financial guarantee contracts

As at 31 December 2020 the Entity did not hold any financial guarantee contracts (2019: nil).

(b) Income and expense

Interest income and expense

Interest income and expense for all financial instruments, excluding those classified as held for trading or designated at fair value are recognised in 'Interest income' and 'Interest expense' in the income statement using the effective interest method.

Interest on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Non-interest income and expense

Fee income is earned from a diverse range of services provided by the Entity to its customers. Fee income is accounted for as follows:

- Income earned on the execution of a performance obligation is recognised as revenue when the act is completed (for example, fees arising from sale of travel money); and
- Income earned from the provision of services is recognised as revenue as the services are provided (for example, interchange fee income).

Fee expense is recognised as services are received or liabilities are accrued.

Directly attributable acquisition costs are recognised over the estimated life of the relevant financial asset or financial liability. For credit cards this is 7 years, and for current accounts 5 years. These are reviewed annually to ensure they remain appropriate.

Other operating Income
Profit share receivable/payable is recognised in accordance with the terms of the Relationship Agreement with M&S plc.

Gains/(losses) on financial instruments are calculated as the difference between the carrying amount of the loan pre-modification and the present value of estimated future cash flows, excluding credit losses, discounted at the loan's original effective interest rate. The Entity has applied this to the carrying value of financial instruments on which customer relief offers were available during the year.

(c) Financial instruments measured at amortised cost

Loans and advances

Financial assets that are held to collect the contractual cash flows and which contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest, are measured at amortised cost. Such financial assets include most loans and advances to banks and customers and some debt securities. In addition, most financial liabilities are measured at amortised cost. The carrying value of these financial assets at initial recognition includes any directly attributable transaction costs.

The Entity may commit to underwriting loans on fixed contractual terms for specified periods of time. When the Entity intends to hold the loan, a provision on the loan commitment is only recorded where it is probable that the Entity will incur a loss.

Critical accounting estimates and judgements

The measurement of loans and advances to customers at amortised cost requires management to estimate the effective interest rate for Credit Cards, and results in the build-up of an asset during promotional periods as interest is accrued and recognised as it is earned but it is not charged to the customer. The value of the EIR asset is heavily dependent upon future assumptions and there is therefore a high degree of estimation uncertainty. Details of the key judgements and assumptions are shown in note 13.

(d) Impairment of amortised cost financial assets

Expected credit losses (ECL) are recognised for loans and advances to banks and customers and other financial assets held at amortised cost. At initial recognition, allowance is required for ECL resulting from default events that are possible within the next 12 months or less, where the remaining life is less than 12 months '12-month ECL'. In the event of a significant increase in credit risk, allowance is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or otherwise credit-impaired are in 'stage 3'.

Credit-impaired (stage 3)

The Entity determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay, such as when a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default.

If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit-impaired.

Interest income is recognised by applying the effective interest rate to the amortised cost amount, i.e. gross carrying amount less ECL allowance.

Write-off

Financial assets (and the related impairment allowances) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.

Renegotiation

Loans are identified as renegotiated and classified as credit-impaired when we modify the contractual payment terms due to significant credit distress of the borrower. Renegotiated loans remain classified as credit-impaired until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows and retain the designation of renegotiated until maturity or derecognition.

A loan that is renegotiated is derecognised if the existing agreement is cancelled and a new agreement is made on substantially different terms or if the terms of an existing agreement are modified such that the renegotiated loan is a substantially different financial instrument.

All modified loans could be transferred out of stage 3 if they no longer exhibit any evidence of being credit-impaired and, in the case of renegotiated loans, there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, over the minimum observation period, and there are no other indicators of impairment. These loans could be transferred to stage 1 or 2 based on the mechanism as described below by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms) and the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms). Any amount written off as a result of the modification of contractual terms would not be reversed.

Significant increase in credit risk (stage 2)

An assessment of whether credit risk has increased significantly since initial recognition is performed at each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument. The assessment explicitly or implicitly compares the risk of default occurring at the reporting date compared to that at initial recognition, taking into account reasonable and supportable information, including information about past events, current conditions and future economic conditions. The assessment is unbiased, probability-weighted, and to the extent relevant, uses forward-looking information consistent with that used in the measurement of ECL. The analysis of credit risk is multifactor. The determination of whether a specific factor is relevant and its weight compared with other factors depends on the type of product, the characteristics of the financial instrument and the borrower. Therefore, it is not possible to provide a single set of criteria that will determine what is considered to be a significant increase in credit risk and these criteria will differ for different types of lending. However, unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when 30 days past due.

Default risk is assessed using a reporting date 12-month Probability of Default (PD) derived from credit scores, which incorporates all available information about the customer. This PD is adjusted for the effect of macroeconomic forecasts for periods longer than 12 months and is considered to be a reasonable approximation of a lifetime PD measure. Exposures are first segmented into homogeneous portfolios, generally by product. Within each portfolio, the stage 2 accounts are defined as accounts with an adjusted 12-month PD greater than the average 12-month PD of loans in that portfolio 12 months before they become 30 days past due. The expert credit risk judgement is that no prior increase in credit risk is significant. This portfolio-specific threshold identifies loans with a PD higher than would be expected from loans that are performing as originally expected, and higher than what would have been acceptable at origination. It therefore approximates a comparison of origination to reporting date PDs.

Unimpaired and without significant increase in credit risk - (stage 1)

ECL resulting from default events that are possible within the next 12 months ('12-month ECL') are recognised for financial instruments that remain in stage 1.

Movement between stages

Financial assets can be transferred between the different categories depending on their relative increase in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described above. Except for renegotiated loans, financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above. Renegotiated loans will continue to be in stage 3 until there is sufficient evidence to demonstrate a significant reduction in the risk of non-payment of future cash flows, observed over a minimum one-year period and there are no other indicators of impairment. Loans are assessed for impairment on a portfolio basis, the evidence typically comprises a history of payment performance against the original or revised terms, as appropriate to the circumstances.

Measurement of ECL

The assessment of credit risk and the estimation of ECL are unbiased and probability-weighted, and incorporate all available information that is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL takes into account the time value of money.

In general, the entity calculates ECL using three main components, a probability of default, a loss given default ('LGD') and the exposure at default ('EAD').

The 12-month ECL is calculated by multiplying the 12-month PD, LGD and EAD. Lifetime ECL is calculated using the lifetime PD instead. The 12-month and lifetime PDs represent the probability of default occurring over the next 12 months and the remaining maturity of the instrument respectively.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdowns of committed facilities. The LGD represents expected losses on the EAD given the event of default taking into account, among other attributes, the mitigating effect of collateral value at the time it is expected to be realised and the time value of money.

The Entity leverages the Basel II IRB framework where possible, with recalibration to meet the differing IFRS 9 requirements set out in the following table:

Model	Regulatory capital	IFRS 9
PD	• Through the cycle (represents long-run average PD throughout a full economic cycle) • The definition of default includes a backstop of 90+ days past due, although this has been modified to 180+ days past due for some portfolios, particularly UK mortgages.	• Point in time (based on current conditions, adjusted to take into account estimates of future conditions that will impact PD) • Default backstop of 90+ days past due for all portfolios
EAD	• Cannot be lower than current balance	• Amortisation captured for term products
LGD	• Downturn LGD (consistent losses expected to be suffered during a severe but plausible economic downturn) • Regulatory floors may apply to mitigate risk of underestimating downturn LGD due to lack of historical data • Discounted using cost of capital • All collection costs included	• Expected LGD (based on estimate of loss given default including the expected impact of future economic conditions such as changes in value of collateral) • No floors • Discounted using the original effective interest rate of the loan • Only costs associated with obtaining/selling collateral included
Other		• Discounted back from point of default to balance sheet date

While 12-month PDs are recalibrated from Basel II models where possible, the lifetime PDs are determined by projecting the 12-month PD using a term structure.

Period over which ECL is measured

Expected credit loss is measured from the initial recognition of the financial asset. The maximum period considered when measuring ECL (be it 12-month or lifetime ECL) is the maximum contractual period over which the group is exposed to credit risk.

Where the financial instrument includes both a drawn and undrawn commitment and the contractual ability to demand repayment and cancel the undrawn commitment does not serve to limit the Entity's exposure to credit risk to the contractual notice period, the contractual period does not determine the maximum period considered. Instead, ECL is measured over the period the Entity remains exposed to credit risk that is not mitigated by credit risk management actions. This applies to overdrafts and credit cards, where the period is the average time taken for stage 2 exposures to default or close as performing accounts, determined on a portfolio basis and ranging from between two and six years.

Forward-looking economic inputs

The Entity follows a HSBC group wide methodology. The group applies multiple forward-looking global economic scenarios determined with reference to external forecast distributions representative of our view of forecast economic conditions. This approach is considered sufficient to calculate unbiased expected loss in most economic environments. In certain economic environments, additional analysis and may be necessary and result in additional scenarios or adjustments, to reflect a range of possible economic outcomes sufficient for an unbiased estimate. The detailed methodology is disclosed in 'Measurement uncertainty and sensitivity analysis of ECL estimates' on page 46.

Critical accounting estimates and judgements

The calculation of the group's ECL under IFRS 9 requires the group to make a number of judgements, assumptions and estimates. The most significant are set out below:

Judgements	Estimates
• Defining what is considered to be a significant increase in credit risk. • Determining the lifetime and point of initial recognition of overdrafts and credit cards. • Selecting and calibrating the PD, LGD and EAD models, which support the calculations, including making reasonable and supportable judgements about how models react to current and future economic conditions. • Selecting model inputs and economic forecasts, including determining whether sufficient and appropriately weighted economic forecasts are incorporated to calculate unbiased expected loss. • Making management judgemental adjustments to account for late breaking events, model and data limitations and deficiencies, and expert credit judgements.	• The measurement uncertainty and sensitivity analysis of ECL estimates on page 46 set out the assumptions used in determining ECL and provide an indication of the sensitivity of the result to the application of different weightings being applied to different economic assumptions.

(e) Employee compensation and benefits

Share-based payments

The Entity enters into equity-settled share-based payment arrangements with its employees as compensation for the provision of their services.

The vesting period for these schemes may commence before the legal grant date if the employees have started to render services in respect of the award before the legal grant date, where there is a shared understanding of the terms and conditions of the arrangement. Expenses are recognised when the employee starts to render service to which the award relates.

Cancellations result from the failure to meet a non-vesting condition during the vesting period, and are treated as an acceleration of vesting recognised immediately in the income statement. Failure to meet a vesting condition by the employee is not treated as a cancellation, and the amount of expense recognised for the award is adjusted to reflect the number of awards expected to vest.

Post-employment benefit plans

The HSBC group operates pension schemes including defined benefit, defined contribution, and post-employment benefit schemes. Further details regarding these schemes are set out in Note 4.

Payments to defined contribution schemes are charged as an expense as the employees render service.

(f) Tax

Income tax comprises current tax and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case the tax is recognised in the same statement in which the related item appears.

Current tax is the tax expected to be payable on the taxable profit for the year and on any adjustment to tax payable in respect of previous years. The Entity provides for potential current tax liabilities that may arise on the basis of the amounts expected to be paid to the tax authorities.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the balance sheet, and the amounts attributed to such assets and liabilities for tax purposes. Deferred tax is calculated using the tax rates expected to apply in the periods as the assets will be realised or the liabilities settled.

Current and deferred tax are calculated based on tax rates and laws enacted, or substantively enacted, by the balance sheet date.

(g) Items in the course of collection from other banks

The Entity recognises items in the course of collection from other banks when funds in respect of customer payments are still to be received from other institutions.

(h) Right-of-use assets

In line with the requirements of IFRS16 the Entity recognises Right-of-use (ROU) assets where leases in respect of its office and branch locations have been entered into.

Leases are recognised as an ROU asset and a corresponding liability at the date at which the leased asset is made available for use with measurement based on the present value of future cash flows over the term of the lease. Lease payments are allocated between the liability and finance cost. The finance cost is charged to profit and loss over the lease term so as to produce a constant period rate of interest on the remaining balance of the liability. The ROU asset is depreciated over the shorter of the ROU asset's useful economic life and the lease term on a straight-line basis.

(i) Property, plant and equipment

Equipment, fixtures and fittings are stated at cost less impairment losses and depreciation over their useful lives, which are generally between 2 years and 5 years. Property, plant and equipment is subject to an impairment review if their carrying amount may not be recoverable.

(j) Intangible assets

Intangible assets are stated at cost less amortisation and are amortised straight line over their estimated useful lives of 5 years. Expenditure on internally developed software is recognised as an asset when the Entity is able to demonstrate its intention and ability to complete the development and use the software in a manner that will generate future economic benefits and can reliably measure the cost to complete development. Borrowing costs are not included in the capitalised costs of intangible assets. Assets are subject to regular impairment reviews which compare the carrying value to the expected value in use. Any impairment losses are recognised in the Income Statement. Amortisation does not commence until the asset is brought into operational use.

(k) Other assets

Other assets include profit share recoverable from M&S plc. Under the terms of the Relationship Agreement (RA) with M&S plc, profits and losses of the Entity are shared equally, after adjustments for capital and funding costs. When the Entity is profitable this results in profit share payable to M&S plc, with settlement on a quarterly basis. In years when the Entity is loss-making, as in 2019 and 2020, there is profit share recoverable from M&S plc. This is recognised as a non-financial asset within the Entity and recovered through offset of future profit share and other fees payable under the RA. The asset is recognised on the balance sheet at cost and in line with the requirements of IAS 36 Impairment of Assets an impairment assessment is performed.

(l) Deposits by banks

Liabilities in respect of borrowings from HSBC UK are recognised within deposits by banks. Deposits by banks are recognised at amortised cost.

(m) Customer accounts

The Entity recognises within customer accounts liabilities for savings deposits received from customers and credit balances which have arisen in respect of unsecured lending products. Customer accounts are measured at amortised cost.

(n) Accruals, deferred income and other liabilities

The Entity recognises liabilities to other group companies in respect of outstanding recharges of costs and settlement of cash transfers. Income in respect of certain products is deferred and recognised over the life of the product where payment has already been made by the customer – for example credit card balance transfer fees. The lease liability in respect of Right-of-use assets is included within other liabilities.

(o) Subordinated liabilities

The Entity recognises subordinated loans from other group entities within subordinated liabilities. Subordinated liabilities are recognised at amortised cost.

(p) Called up share capital

Financial instruments issued are generally classified as equity when there is no contractual obligation to transfer cash or other financial assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Share capital for the Entity consists of ordinary shares, issued and fully paid.

(q) Cash and balances at central banks

Cash and balances at central banks include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with less than three months' maturity from the date of acquisition.

2. Operating Loss

Operating loss is stated after the following items:

	2020 £'000	2019 £'000
Interest income		
Loans and advances to customers	**194,631**	239,226
Interest received from group undertakings	**6,201**	13,273
Other interest payable	**(3,082)**	(3,028)
Total interest income	**197,750**	252,503
Interest expense		
Customer accounts	**7,590**	16,285
Interest paid to group undertakings	**24,443**	30,901
Other interest paid	**499**	452
Total interest expense	**32,532**	47,638
Fee and commission income		
Product fee income	**43,510**	83,665
Insurance income	**15,475**	17,058
Other income	**5,222**	4,740
Total fee and commission income	**64,207**	105,463
Fee and commission expense		
Product acquisition and retention costs	**18,643**	21,299
Fees payable to group undertakings	**—**	145
Other fees paid	**9,266**	14,242
Total fee and commission expense	**27,909**	35,686
Change in expected credit losses and other credit impairment charges		
Change in expected credit losses and other credit impairment charges	**155,851**	70,289
Total change in expected credit losses and other credit impairment charges	**155,851**	70,289
General and administrative expenses		
Remediation costs	**(16,081)**	220,251
Expenses payable to group undertakings	**42,188**	35,526
Other expenses	**39,620**	49,905
Total general and administrative expenses	**65,727**	305,682

3. Other operating income

	2020 £'000	2019 £'000
Sublease rental income	**426**	568
Gains/ (losses) on financial instruments	**(911)**	—
M&S plc Profit Share income	**33,816**	65,697
Total other operating income	**33,331**	66,265

4. Employee compensation and benefits

Total employee compensation

	2020 £'000	2019 £'000
Wages and salaries including share-based payments	**35,928**	37,147
Social security costs	**3,169**	3,272
Post-employment benefits	**5,384**	5,446
Year ended 31 Dec	**44,481**	45,865

Employee compensation is paid by HSBC and recharged to the Entity.

Average number of persons employed by the Entity during the year

	2020	2019
Head Office Administration	**572**	645
Selling and Distribution	**766**	731
Year ended 31 Dec	**1,338**	1,376

Post employment benefit plans

The principal plan

The Entity's employees are either members of DC schemes solely or members of DC and DB schemes.

The defined benefit section was closed to future benefit accrual in 2015, with defined benefits earned by employees at that date continuing to be linked to their salary while they remain employed by HSBC UK Bank plc. The plan is overseen by an independent corporate trustee, who has a fiduciary responsibility for the operation of the plan. Its assets are held separately from the assets of the group.

There is no contractual agreement or stated policy for charging the net defined benefit cost from HSBC UK Bank plc to the other members of the group pension plan. Instead the Entity makes a regular payment to HSBC UK Bank plc, for HSBC UK Bank plc to invest in the various schemes on behalf of the Entity's employees. The Entity would not contribute to any scheme deficit, except through amendments to its regular payments. Full disclosure of the principal actuarial financial assumptions used to calculate the defined benefit pension plans at 31 December 2020, of which employees of the Entity are members, are disclosed in the statutory accounts of HSBC UK Bank plc.

5. Share-based payments

The share-based payment income statement charge is recognised in wages and salaries as follows:

	2020	2019
	£'000	£'000
Savings-related and other share award option plans	**638**	399
Year ended 31 Dec	**638**	399

HSBC share option plans

Plans	Policy
Savings-related share option plans ('Sharesave')	• Eligible employees can save up to £500 per month with the option to use the savings to acquire shares. • Exercisable within six months following either the third or fifth anniversary of the commencement of a three-year or five year contract, respectively. • The exercise price is set at a 20% (2019: 20%) discount to the market value immediately preceding the date of invitation.

Calculation of fair values

The fair values of share options are calculated using a Black-Scholes model. The fair value of a share award is based on the share price at the date of the grant.

Movement on HSBC share option plans

	Savings-related share options	
	Number	**WAEP[1]**
		£
Outstanding at 1 Jan 2020	**1,312**	**5.74**
Granted during the year	**669**	**2.63**
Exercised during the year	**(246)**	**2.77**
Expired during the year	**(511)**	**5.02**
Outstanding at 31 Dec 2020	**1,224**	**5.11**
Weighted average remaining contractual life (years)		**2**

	Savings-related share options	
	Number	WAEP[1]
		£
Outstanding at 1 Jan 2019	1,303	5.84
Granted during the year	586	4.69
Exercised during the year	(301)	4.45
Expired during the year	(276)	5.41
Outstanding at 31 Dec 2019	1,312	5.74
Weighted average remaining contractual life (years)		2

[1] *The weighted average exercise price (WAEP) of share options outstanding, which is calculated when transactions are contracted, was* £4.55 *(*2019*:* £6.22*).*

6. Directors' emoluments

The aggregate emoluments of the Directors of the Entity, computed in accordance with the Companies Act 2006 as amended by statutory instrument 2008 No. 410, were:

	2020	2019
	£'000	£'000
Fees [1]	**133**	189
Salaries and other emoluments [2]	**408**	516
Pension contributions	**35**	53
Annual incentives [3]	**147**	163
Year ended 31 Dec	**723**	921

1 *Fees include fees paid to non-executive Directors.*

2 *Salaries and other emoluments include fixed pay allowance.No remuneration is disclosed for Directors who are employed by other companies within the HSBC Group and their services are incidental to their other responsibilities within the HSBC Group.*

3 *Awards made to executive Directors in respect of 2020 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £138,600 in cash, nil in deferred cash (vesting annually over a three year period), nil in restricted shares and £9,900 in deferred restricted shares (vesting annually over a three year period) issued under the HSBC Share Plan.*

Awards made to executive Directors in respect of 2019 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £98,100 in cash, £11,700 in deferred cash (vesting annually over a three year period), £35,100 in restricted shares and £18,000 in deferred restricted shares (vesting annually over a three year period) issued under the HSBC Share Plan.

No Directors exercised share options over HSBC Holdings plc ordinary shares during the year (2019: two).

Awards were made to two Directors under long-term incentive plans in respect of qualifying services rendered in 2020 (2019: four Directors). During 2020, two Directors received shares in respect of awards under long-term incentive plans that vested during the year (2019: four).

No retirement benefits are accruing to Directors under a defined benefit scheme and are accruing to 0 Directors under money purchase schemes in respect of Directors' qualifying service. Contributions of £35,100 (2019: £53,100) were made during the year to money purchase arrangements and £nil to defined benefit schemes in respect of Directors' qualifying service (2019: £nil).

Discretionary bonuses for Directors are based on a combination of individual and corporate performance and are determined by the Remuneration Committee of the Entity's ultimate parent company, HSBC Holdings plc. The cost of any conditional awards under the HSBC Share Plan and the HSBC Plan 2011 ('the Plans') is recognised through an annual charge based on the fair value of the awards, apportioned over the period of service to which the award relates. Details of the Plans are contained within the Directors' Remuneration Report of HSBC Holdings plc.

Of these aggregate figures, the following amounts are attributable to the highest paid Director:

	2020 £'000	2019 £'000
Salaries and other emoluments	**245**	226
Annual incentives [1]	**95**	95
Year ended 31 Dec	**340**	321

[1] *Awards made to the highest paid Director in respect of 2020 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £ 85,500 in cash, nil in deferred cash (vesting annually over a three year period), nil in restricted shares and £9,900 in deferred restricted shares (vesting annually over a three year period) issued under the HSBC Share Plan.*
Awards made to the highest paid Director in respect of 2019 performance comprise a mixture of cash and HSBC Holdings plc ordinary shares. The amount shown comprised £35,100 in cash, £11,700 in deferred cash (vesting annually over a three year period), £35,100 in restricted shares and £12,600 in deferred restricted shares (vesting annually over a three year period) issued under the HSBC Share Plan.

The highest paid Director received 9,277 (2019: 8,992) shares, in respect of qualifying services, as the result of awards under long-term incentive plans that vested during the year. The highest paid Director exercised no (2019: none) share options over HSBC Holdings plc ordinary shares during the year.

Pension contributions of £5,400 (2019: £9,900) were made by the Entity in respect of services by the highest paid Director during the year.

7. Auditors' remuneration

	2020 £'000	2019 £'000
Audit fees for statutory audit		
- Fees relating to current year	**479**	364
- Other audit-related services pursuant to regulation	**34**	40
- Other services	**7**	16
Year ended 31 Dec	**520**	420

Certain elements of audit work are performed centrally across the HSBC group. These items are not recharged to the Entity.

8. Tax credit/(expense)

Tax expense

	2020 £'000	2019 £'000
Current tax		
UK corporation tax		
- For this year	**(10,794)**	31,123
- Adjustments in respect of prior years	**2,093**	(495)
Total current tax	**(8,701)**	30,628
Deferred tax		
- For this year	**1,760**	1,961
- Effects of changes in tax rates	**(1,029)**	(61)
- Adjustments in respect of prior years	**(404)**	131
Total deferred tax	**327**	2,031
Year ended 31 Dec (profit)/ loss	**(8,374)**	32,659
Equity items		
- Current tax	**4**	(56)
- Deferred tax - current year	**(7)**	75
Total equity items	**(3)**	19

The UK corporation tax rate applying to the Entity was 27%, comprising 19% UK corporation tax plus 8% surcharge tax rate on UK banking profits (2019: 27%).

In addition to the amount charged to the income statement, the aggregate amount of current and deferred tax relating to items that are credited directly to equity is £3k.

Tax reconciliation

The tax credited to the income statement differs from the tax expense that would apply if all profits had been taxed at the UK corporation tax rate as follows:

	2020		2019	
	£'000	(%)	£'000	(%)
Loss before tax	**(35,659)**		(85,901)	
Tax at 19% (2019: 19%)	**(6,775)**	**19.00**	(16,321)	19.00
Adjustments in respect of prior years	**1,690**	**(4.74)**	(364)	0.42
Permanent disallowables	**1,944**	**(5.45)**	57,508	(66.95)
Impact due to changes in tax rates	**(1,029)**	**2.89**	(61)	0.07
Deductions for AT1 coupon payments	**(1,351)**	**3.79**	(1,231)	1.43
Banking surcharge	**(2,853)**	**8.00**	(6,872)	8.00
Year ended 31 Dec (profit)/ loss	**(8,374)**	**23.48**	32,659	(38.02)

Permanent disallowables include adjustments relating to the skilled person review offset by the impact of PPI provision releases. This is due to the government making banks' conduct payments non-deductible for corporation tax purposes from July 2015.

9. Deferred tax assets

The following table shows the non current gross deferred tax assets and liabilities recognised in the balance sheet and the related amounts recognised in the income statement:

	Property, plant and equipment	**Share based payments**	**Other temporary differences**	**IFRS 9 Transitional Adjustments**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
At 1 Jan 2020	**4,461**	**84**	**–**	**7,983**	**12,528**
Income statement charge	**(285)**	**(40)**	**32**	**(438)**	**(731)**
Equity statement credit	**–**	**7**	**–**	**–**	**7**
Prior year adjustments	**4**	**–**	**399**	**–**	**403**
At 31 Dec 2020	**4,180**	**51**	**431**	**7,545**	**12,207**

	Property, plant and equipment	Share based payments	Other temporary differences	IFRS 9 Transitional Adjustments	Total
	£'000	£'000	£'000	£'000	£'000
At 1 Jan 2019	5,138	199	239	9,058	14,634
Income statement (charge)/credit	(709)	(40)	(74)	(1,075)	(1,898)
Equity statement expense	–	(75)	–	–	(75)
Prior year adjustments	32	–	(165)	–	(133)
At 31 Dec 2019	4,461	84	–	7,983	12,528

Management has assessed the likely availability of future taxable profits against which to recover the deferred tax assets of the Entity and the HSBC group, taking into consideration the reversal of existing taxable temporary differences, past business performance and forecasts of future business performance. Management is satisfied that although the Entity and the HSBC group recorded a tax loss for the year, as a result of the impacts of Covid-19, the aforementioned evidence is sufficient to support recognition of all deferred tax assets.

10. Reconciliation of (loss)/profit before tax to net cash flow from operating activities

	2020	2019
	£'000	£'000
Loss before tax	**(35,659)**	(85,901)
Non-cash items included in profit and loss		
Depreciation, amortisation and impairment	**4,447**	5,025
Credit-related impairment losses	**112,246**	46,747
Increase/(decrease) in provisions	**(103,145)**	80,707
Profit on disposal of investments	**–**	(53)
	13,548	132,426
Change in operating assets		
Change in prepayments and accrued income	**986**	(2,409)
Change in loans and advances to customers	**787,042**	(411,300)
Change in other assets	**(34,307)**	(91,023)
Change in balances with central banks	**–**	4,336
Change in Loans and advances to banks	**(440,000)**	65,000
	313,721	(435,396)
Change in operating liabilities		
Change in accruals and deferred income	**(3,668)**	(248)
Change in customer accounts	**55,275**	(126,918)
Change in other liabilities	**(29,201)**	(24,080)
	22,406	(151,246)
Cash and cash equivalents comprise		
Cash and balances at central banks [1]	**10,365**	9,361
Items in the course of collection from other banks	**9,267**	7,704
Loans and advances to banks of one month or less	**938,658**	1,465,247
Deposit by banks of one month or less	**(155,000)**	(230,000)
Less: Items in the course of transmission to other banks	**(3,275)**	(6,589)
	800,015	1,245,723

[1] At 31 December 2020 £4.1m, (2019: £5.4m) was not available for use by the Entity as it relates to mandatory deposits at central banks.

11. Fair value of financial instruments not carried at fair value

Where repricing is greater than six months using discounted cash flow, each loan or deposit is valued using a LIBOR-based discount curve applied to the expected cash flows.

Fair values at the balance sheet date of the assets and liabilities set out below are estimated for the purpose of disclosure as follows:

		Fair values			
			Valuation techniques		
	Carrying amount	Quoted price	Using observable inputs	With significant unobservable inputs	
		Level 1	Level 2	Level 3	Total
	£'000	£'000	£'000	£'000	£'000
At 31 Dec 2020					
Assets					
Loans and advances to banks	**1,613,658**	**–**	**1,613,658**	**–**	**1,613,658**
Loans and advances to customers	**3,239,177**	**–**	**–**	**3,239,177**	**3,239,177**
Liabilities					
Deposits by banks	**2,260,034**	**–**	**2,260,034**	**–**	**2,260,034**
Customer accounts	**2,178,589**	**–**	**2,178,589**	**–**	**2,178,589**
Subordinated liabilities	**95,164**	**–**	**95,164**	**–**	**95,164**
At 31 Dec 2019					
Assets					
Loans and advances to banks	1,700,247	–	1,700,247	–	1,700,247
Loans and advances to customers	4,138,465	–	–	4,138,465	4,138,465
Liabilities					
Deposits by banks	3,055,000	–	3,055,000	–	3,055,000
Customer accounts	2,123,314	–	2,123,314	–	2,123,314
Subordinated liabilities	95,202	–	95,202	–	95,202

Other financial instruments not carried at fair value are typically short-term in nature and reprice to current market rates frequently. Accordingly, their carrying amount is a reasonable approximation of fair value. They include cash and balances at central banks and items in the course of collection from and transmission to other banks, all of which are measured at amortised cost.

Valuation

Fair value is an estimate of price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. It does not reflect the economic benefits and costs that the Entity expects to flow from an instrument's cash flow over its expected future life. The Entity's valuation methodologies and assumptions in determining fair values for which no observable market price are available may differ from those of other companies.

Loans and advances to banks and customers

The carrying amount of loans and advances is deemed a reasonable approximation of fair value, given the related maturity and interest rate on the instruments.

Deposits by banks, customer accounts and subordinated liabilities

The carrying amount of deposits by banks, customer accounts and subordinated liabilities are deemed a reasonable approximation of fair value, given the related maturity and interest rate on the instruments.

12. Loans and advances to banks

	2020	2019
	£'000	£'000
Loans and advances held with parent	**1,612,879**	1,699,633
Nostro balances with parent and fellow subsidiaries	**779**	614
At 31 Dec	**1,613,658**	1,700,247

Amounts due from group undertakings are unsecured, interest bearing and have fixed dates of repayment which range from 4 January 2021 to 15 November 2023. All loans and advances to other banks have variable interest rates and are repayable on demand.

Nostro balances are variable rate and totalled £0.8m.

13. Loans and advances to customers

	2020	2019
	£'000	£'000
Gross loans and advances to customers	**3,479,622**	4,266,221
Expected credit losses provision (Note 26)	**(240,445)**	(127,756)
At 31 Dec	**3,239,177**	4,138,465

Loans and advances to customers by industry sector

	2020		2019	
	Gross loans and advances to customers	**Gross loan by industry as % of total gross loans**	Gross loans and advances to customers	Gross loan by industry as % of total gross loans
	£'000	**%**	£'000	%
Residential mortgages	**228,938**	**7 %**	216,647	5 %
Cards	**2,053,557**	**59 %**	2,583,156	61 %
Consumer Loans	**1,182,349**	**34 %**	1,447,284	34 %
Other Personal	**14,778**	**— %**	19,134	— %
At 31 Dec	**3,479,622**	**100 %**	4,266,221	100 %
Impaired loans	**72,437**		69,963	
as a % of total	**2.1**		1.6	

The measurement of loans and advances to customers at amortised cost requires management to estimate the effective interest rate (EIR) for Credit Card and results in the build-up of an asset during promotional periods as interest is accrued but not earned. This has resulted in the recognition of £63.3m within loans and advances to customers as at 31 December 2020 (31 December 2019: £68.3m).

The effective interest approach incorporates a number of key assumptions as follows:

- the estimated life of the customer account (currently 7 years);
- future balance forecasts; and
- future interest forecasts.

The estimated life is reviewed annually and the Entity has assessed 7 years as continuing to be the most appropriate life (2019: 7 years).

Future balance and interest forecasts are initially established using internal pricing models and are reviewed regularly to reflect actual experience. A key metric is the proportion of acquired accounts which remain active after the end of promotional period. Where these proportions differ from forecast in relation to balance and interest an adjustment to the carrying value of the asset must be recognised in the financial statements.

Management have assessed the sensitivity of balance and interest assumptions by considering the impact of changes to these on significant offer plans.

In the case of front book plans (31 December 2020 asset value: £50.2m), a 5% decrease in the balance of the proportion of acquired accounts which remain active at the end of the promotional period would decrease the asset value by £2.6m. A 5% *decrease in the assumed interest yield would decrease the asset value by £6.4m.*

In the case of back book plans (31 December 2020 asset value: £13.1m), a 5% decrease in the balance of the proportion of acquired accounts which remain active at the end of the promotional period would decrease the asset value by £0.6m. A 5% decrease in the assumed interest yield would decrease the asset value by £1.0m.

Conversely, increases in the above assumptions would increase asset values by similar amounts.

Seven year life assumption

A sensitivity analysis has been performed to assess the impact of utilising six year life assumption, this would reduce the asset value by £11m.

14. Property, plant and equipment

	Equipment, fixtures and fittings	
	2020	2019
	£'000	£'000
Cost		
At 1 Jan	**50,749**	50,067
Additions	**563**	682
As at 31 Dec	**51,312**	50,749
Accumulated depreciation		
At 1 Jan	**49,203**	48,466
Charge for the year	**629**	737
As at 31 Dec	**49,832**	49,203
Net book value		
At 1 Jan	**1,546**	1,601
As at 31 Dec	**1,480**	1,546

15. Intangible assets

	Software development costs	
	2020	2019
	£'000	£'000
Cost		
At 1 Jan	**56,131**	56,329
Additions	**519**	–
Adjustment	**–**	(198)
As at 31 Dec	**56,650**	56,131
Accumulated amortisation		
At 1 Jan	**54,640**	54,785
Charge for the year	**529**	330
Adjustment	**474**	(475)
As at 31 Dec	**55,643**	54,640
Net book value		
At 1 Jan	**1,491**	1,544
As at 31 Dec	**1,007**	1,491

16. Other assets

	2020	2019
	£'000	£'000
Amounts due from group undertakings	**34,654**	28,421
Profit Share due from M&S plc	**120,378**	88,563
Other items due from M&S plc	**5,882**	12,408
Other assets	**8,996**	6,210
At 31 Dec	**169,910**	135,602

Amounts due from group undertakings are unsecured and repayable on demand.

Profit share due from M&S plc will be recovered in line with the Relationship Agreement (RA), through offsetting future profit share charges as profits are earned. In line with the requirements of IAS 36 an impairment assessment has been performed to take account of potential variability in future cash flows required to recover the balance.

The impairment assessment considers the recoverability of the asset with recovery dependent upon future profits of the Entity's business which are forecast within the Annual Operating Plan of the Entity over the period 2021-2025. This indicates full recovery in August 2024, which is within the term of the current RA which runs until November 2024. Consideration of future cash flows over the period 2021-2025 indicate a positive value in use and no impairment requirement as at 31 December 2020.

There is uncertainty around the future profitability of the Entity which may impact the recovery period. The main challenges to the recovery period are the extent to which credit card and travel money trading volumes recover from the impact of the Covid-19 pandemic, and the uncertain economic outlook which may result in additional expected credit losses. Future trading initiatives such as card portfolio management may result in a shorter recovery period.

17. Deposits by banks

	2020 £'000	2019 £'000
Amounts due from group undertakings	**2,260,034**	3,055,000
At 31 Dec	**2,260,034**	3,055,000

Amounts due to group undertakings are unsecured, interest bearing and have fixed dates of repayment which range from 4 January 2021 to 15 November 2023.

18. Customer accounts

	2020 £'000	2019 £'000
Credit balances on loans and advances to customers	**12,473**	8,946
Customer deposits	**2,166,116**	2,114,368
At 31 Dec	**2,178,589**	2,123,314

Customer savings deposits have both fixed and variable interest rates and are repayable on demand. Customer deposits with variable rates totalled £1,797m (2019: £1,742m). Customer deposits with fixed rates totalled £370m (2019: £372m).

19. Accruals, deferred income and other liabilities

	2020 £'000	2019 £'000
Accruals and deferred income	**14,610**	18,279
Amounts owed to immediate parent	**2,217**	4,854
Amounts owed to other group companies	**13,820**	20,949
Items in the course of settlement	**20,227**	35,627
Lease Liabilities	**17,116**	19,338
Other liabilities	**4,636**	6,570
At 31 Dec	**72,629**	105,617

Amounts repayable to group companies and the immediate parent are unsecured, interest free and have no fixed date of repayments. Details for the leases entered into are set out in note 25.

20. Provisions

	Restructuring Provision	Skilled person review Provision	NOSIA Provision	Customer redress Provision	Fraud Provision	ECL on undrawn commitments	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
At 1 Jan 2020	**2,183**	**15,192**	**246**	**176,803**	**444**	**639**	**195,507**
Increase/(Decrease) in provision	**955**	**21,564**	**–**	**(18,374)**	**–**	**3,433**	**7,578**
Provision utilised	**(1,867)**	**–**	**(13)**	**(108,627)**	**–**	**–**	**(110,507)**
Provision released	**(217)**	**–**	**–**	**–**	**–**	**–**	**(217)**
At 31 Dec 2020	**1,054**	**36,756**	**233**	**49,802**	**444**	**4,072**	**92,361**
At 1 Jan 2019	743	–	–	113,312	–	745	114,800
Increase/(Decrease) in provision	1,797	15,192	13,323	212,229	444	(106)	242,879
Provision utilised	(268)	–	(13,077)	(148,738)	–	–	(162,083)
Provision released	(89)	–	–	–	–	–	(89)
At 31 Dec 2019	2,183	15,192	246	176,803	444	639	195,507

Restructuring provision

A provision of £1.1m (2019: £2.1m) exists for redundancy payments to a number of employees where employment is to be terminated as part of a restructuring programme. The provision reflects the full amount of payments agreed with the individuals affected.

Customer redress - Collections and recoveries related matters (skilled persons review)

At 31 December 2020, a provision of £36.8m was held to the estimated liability for redress payable to customers following a review of historical collections and recoveries practices in the UK, including the Entity.

The provision has been estimated based on a number of customer cohorts who may have been impacted and the operational costs of the programme. While most of these cohorts have been fully evaluated, there remain a number of assumptions within the provision for the remaining cohorts which are highly judgmental. The provision has been adjusted to reflect the latest available information, but remains subject to significant judgment. As a result, the provision has been increased by £22m to take account of these factors and the impact on the operational costs. In addition, payments have commenced in relation to customers in those cohorts within which redress assessment has been completed.

Redress is expected to be complete during 2021 but work to complete the evaluation of each cohort and finalise relevant data continues and there is significant judgment to be required surrounding the amount of any redress to be paid.

For the cohorts where judgmental assumptions to calculate the total provision continue to be applied, a 20% increase/decrease in the level of redress to be paid in respect of fees and charges would lead to a £8m increase/decrease in total redress payable.

Customer redress - PPI

At 31 December 2020, £50m (2019: £177m) of the customer remediation provision relates to the estimated liability for redress in respect of the possible mis-selling of payment protection insurance ('PPI') policies in previous years. Of the £177m balance at 31 December 2019, £109m has been utilised during 2020.

A release in provisions of £18m was recognised during the year, primarily reflecting:

- lower than previously expected volumes of valid claims emerging from information requests received prior to the FCA time bar deadline. This led to a reduction in redress payments.
- a revaluation of expected future payments to be made.
- an updated estimate of the amount of redress expected to be paid in relation to claims brought by the Official Receiver.

The estimated liability for redress consists of the following components:

a. For those claims yet to be resolved and paid, including those pursued via litigation, redress is calculated on the basis on the return of the total premiums and related interest paid by the customer, plus simple interest of 8% per annum. Future estimated redress levels are based on historically observed redress paid to customers per policy.

b. The provision held with respect to claims brought by the Official Receiver has been calculated in line with the same methodology.

c. Operating expenses relating to those claims yet to be worked, and with programme closure.

The remaining PPI provision remains sensitive to changes in assumptions and estimates relating to the profile of claims yet to be received or assessed, and to changes in recent experience. This could lead to uphold rates or average redress levels being observed which differ from those included in arriving at the provision.

- A 20% increase/decrease in the uphold rate and average redress for complaints yet to be worked would increase/ decrease the redress provision by approximately £9m.
- A 20% increase/decrease in the volume of future claims received via litigation would increase/decrease the redress provision by approximately £5m.

The Entity continued to monitor all available information up until the date of the approval of the quarterly report to ensure that the provision estimate was appropriate.

ECL on undrawn commitments

Further disclosure on 'ECL on undrawn commitments' can be found in the Credit Risk section of Note 26.

21. Subordinated liabilities

	2020 £'000	2019 £'000
£54m floating rate loan maturing March 2026[1]	**54,127**	54,149
£25m floating rate loan maturing December 2027[2]	**25,032**	25,043
£9m floating rate loan maturing June 2029[3]	**9,002**	9,004
£7m floating rate loan maturing December 2029[4]	**7,003**	7,006
At 31 Dec	**95,164**	95,202

The subordinated loans above are presented on an IFRS accounting basis at amortised cost plus accrued interest. The loans rank behind senior obligations and qualify for inclusion within the Entity's tier 2 capital resources (loan value only).

No additional tier 2 subordinated loans were issued in 2020. The Entity has not had any defaults of principal or interest or other breaches with respect to its subordinated liabilities during the years ended 31 December 2020 and 2019.

[1] *Lender is HSBC UK Holdings Limited. The interest rate is three month sterling Libor plus 4.05%.*

[2] *Lender is HSBC UK Holdings Limited. The interest rate is three month sterling Libor plus 1.925%.*

[3] *Lender is HSBC UK Bank plc. The interest rate is three month sterling Libor plus 2.12%.*

[4] *Lender is HSBC UK Bank plc. The interest rate is three month sterling Libor plus 1.63%.*

22. Maturity analysis of assets and liabilities

The following is an analysis of assets and liabilities by residual contractual maturities at the balance sheet date.

	On demand	Due within 3 months	Due between 3 - 12 months	Due between 1 - 5 years	Due after 5 years	No contractual notice period	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Cash and balances with central banks	10,365	—	—	—	—	—	10,365
Items in the course of collection from other banks	9,267	—	—	—	—	—	9,267
Loans and advances to banks	8,658	1,370,000	130,000	105,000	—	—	1,613,658
Loans and advances to customers	12,343	2,010,097	332,751	863,248	20,738	—	3,239,177
Current Tax	—	—	10,791	—	—	—	10,791
Prepayments and accrued income	—	2,872	—	—	—	—	2,872
Other assets	—	49,532	—	—		120,378	169,910
Right-of-use assets	—	—	337	—	17,043	—	17,380
Non-financial assets	—	—	—	—	—	14,694	14,694
At 31 Dec 2020	**40,633**	**3,432,501**	**473,879**	**968,248**	**37,781**	**135,072**	**5,088,114**
Liabilities and Equity							
Deposits by banks	34	475,000	700,000	1,085,000	—	—	2,260,034
Customer accounts	2,178,589	—	—	—	—	—	2,178,589
Items in the course of transmission to other banks	3,275	—	—	—	—	—	3,275
Accruals and other financial liabilities	—	3,523	7,444	6,043	106	55,513	72,629
Subordinated liabilities	—	164	—	—	95,000	—	95,164
Provisions	—	25,610	6,711	23,285	—	36,755	92,361
Non-financial liabilities	—	—	—	—	—	—	—
Equity	—	—	—	—	—	386,062	386,062
At 31 Dec 2020	**2,181,898**	**504,297**	**714,155**	**1,114,328**	**95,106**	**478,330**	**5,088,114**

Loans and Advances to customers maturity has been updated in 2020 to reflect potential customer behaviour.

Other assets includes profit share recoverable from M&S plc, given the nature of the contract recovery will be over a period of time.

	On demand	Due within 3 months	Due between 3 - 12 months	Due between 1 - 5 years	Due after 5 years	No contractual notice period	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Assets							
Cash and balances with central banks	9,361	—	—	—	—	—	9,361
Items in the course of collection from other banks	7,704	—	—	—	—	—	7,704
Loans and advances to banks	95,247	1,390,000	110,000	105,000	—	—	1,700,247
Loans and advances to customers	11,801	2,663,621	430,043	1,007,269	25,731	—	4,138,465
Prepayments and accrued income	—	3,858	—	—	—	—	3,858
Other assets	—	54,476	19,908	61,218	—	—	135,602
Right-of-use assets						19,201	19,201
Non-financial assets	—	—	—	—	—	15,565	15,565
At 31 Dec 2019	124,113	4,111,955	559,951	1,173,487	25,731	34,766	6,030,003
Liabilities and Equity							
Deposits by banks	—	705,000	1,015,000	1,335,000	—	—	3,055,000
Customer accounts	2,123,314	—	—	—	—	—	2,123,314
Items in the course of transmission to other banks	6,589	—	—	—	—	—	6,589
Accruals and other financial liabilities	—	965	2,922	15,451	—	86,279	105,617
Subordinated liabilities	—	202	—	—	95,000	—	95,202
Provisions	—	52,049	101,864	26,403	—	15,191	195,507
Non-financial liabilities	—	31,066	—	—	—	—	31,066
Equity	—	—	—	—	—	417,708	417,708
At 31 Dec 2019	2,129,903	789,282	1,119,786	1,376,854	95,000	519,178	6,030,003

23. Called up share capital

Called up share capital

Marks and Spencer Financial Services plc ordinary shares of £1.00 each, issued and fully paid

	2020		2019	
	Number	**£'000**	Number	£'000
Issued, allotted and fully paid up				
Ordinary shares of £1 each				
As at 1 Jan	**260,000,000**	**260,000**	93,000,000	93,000
Issued during the year	**—**	**—**	167,000,000	167,000
As at 31 Dec	**260,000,000**	**260,000**	260,000,000	260,000

No ordinary shares were issued in 2020.

Other equity instruments

Marks and Spencer Financial Services plc additional tier 1 instruments

	2020	2019
	£'000	£'000
£40m Undated Subordinated Additional Tier 1 instrument issued 2016 (callable March 2021) [1]	**40,000**	40,000
£20m Undated Subordinated Additional Tier 1 instrument issued 2017 (callable December 2022) [2]	**20,000**	20,000
£9m Undated Subordinated Additional Tier 1 instrument issued 2019 (callable December 2024) [3]	**9,000**	9,000
At 31 Dec	**69,000**	69,000

[1] *Holder is HSBC UK Holdings Limited. The interest rate is fixed at 8.5625%.*

[2] *Holder is HSBC UK Holdings Limited. The interest rate is fixed at 5.25%.*

[3] *Holder is HSBC UK Bank plc. The interest rate is fixed at 4.75%.*

All the Entity's additional tier 1 capital instruments are perpetual in nature with a fixed rate of interest. The instruments are repayable, at the option of the Entity, in whole at the initial call date, or on any interest payment date after the initial call date. Interest is payable at the sole discretion of the Entity and is therefore accounted for as equity and included in the Entity's capital base as fully CRD IV compliant additional tier 1 capital.

No additional tier 1 capital instruments were issued during 2020.

24. Contingent liabilities, contractual commitments and guarantees

The following table gives the nominal principal amounts of off-balance sheet transactions:

	2020	2019
	£'000	£'000
	Contract amount	Contract amount
Commitments		
Undrawn formal standby facilities, credit lines and other commitments to lend	**11,607,912**	11,122,169
At 31 Dec	**11,607,912**	11,122,169

The table above discloses the nominal principal amounts, which represent the maximum amounts at risk should the contracts be fully drawn upon and clients default. As a significant portion of commitments are expected to expire without being drawn upon, the total of the nominal principal amounts is not indicative of future liquidity requirements. The expected credit loss provision relating to commitments under IFRS 9 is disclosed in Note 26.

Various HSBC Group companies, including the Entity, are subject to an investigation by the FCA in connection with historical collections and recoveries operations in the UK. This matter is at a very early stage. Based on the facts currently known, it is not practicable at this time for the Entity to predict the resolution of this matter, including the timing or any possible impact on the Entity, which could be significant.

Contingent liabilities relate to regulatory matters arising out of the Entity's normal business operations.

25. Right-of-use assets

	Right-of-use asset	
	2020	2019
	£'000	£'000
Cost		
At 1 Jan	**23,159**	23,159
Lease modifications [1]	**7,567**	–
Reduction of lease term [2]	**(6,098)**	–
As at 31 Dec	**24,628**	23,159
Accumulated depreciation		
At 1 Jan	**3,958**	–
Charge for the year	**3,290**	3,958
As at 31 Dec	**7,247**	3,958
Net book value		
At 1 Jan	**19,201**	23,159
As at 31 Dec	**17,380**	19,201

Right-of-use assets include leases in respect of the Entities office and branch locations.

[1] A review of leases in early 2020 led to extensions of all lease terms from 2024 to 2029.
[2] In December 2020 following a review of property requirements notice was given for termination of the lease on a building used by the Entity, thereby reducing the term of the lease.

26. Management of financial risk

All of the Entity's activities involve to varying degrees, the analysis, evaluation, acceptance and management of risks or combination of risks. The most important types of risk include financial risk, which comprises credit risk, liquidity risk and market risk. The management of financial risk and consideration of profitability, cash flows and capital resources form a key element in the Directors' assessment of the Entity as a going concern.

Credit risk management

Credit risk is the risk of financial loss if a customer or counterparty of the Entity fails to meet a payment obligation under a contract. Credit risk arises from direct lending.

Within the overall framework of the HSBC Group policy, the Entity has an established risk management process encompassing credit approvals, the control of exposures, credit policy direction to the business, and the monitoring and reporting of exposures.

The management of the Entity is responsible for the quality of its credit portfolios and follows a credit process involving delegated approval authorities and credit procedures, the objective of which is to identify problem exposures in order to accelerate remedial action while building a portfolio of high quality risk assets. The Entity's credit risk rating systems and processes differentiate exposures in order to highlight those with greater risk factors and higher potential severity of loss. Regular reviews are undertaken to assess and evaluate levels of risk concentration.

The Entity's risk rating system facilitates the internal ratings-based ('IRB') approach under Basel II to support calculation of the minimum credit regulatory capital requirement.

Credit risk in 2020

The credit risk effects of the Covid-19 outbreak and the UK withdrawal from the EU continue to be carefully followed by the Entity. Certain industry segments have found themselves challenged and this trend is likely to continue, with some customers having been obliged to take on additional balance sheet leverage.

Following a temporary pause in the issuance of default notices, this activity has now recommenced.

More details analysis of ECL can be found on pages 46 and 51.

A summary of current policies and practices regarding credit risk is set out on pages 26-28.

Summary of credit risk

The disclosure below presents the gross carrying/nominal amount of financial instruments to which the impairment requirements in IFRS 9 are applied and the associated allowance for ECL.

The IFRS 9 allowance for ECL has increased from £128m at 1 January 2020 to £245m at 31 December 2020. The IFRS 9 allowance for expected credit losses ('ECL') at 31 December 2020 comprises of £241m in respect of assets held at amortised cost and £4m in respect of loan commitments.

The following table provides an overview of the Entity's credit risk exposure.

Summary of financial instruments to which the impairment requirements of IFRS 9 are applied

	2020		2019	
	Gross carrying/ nominal amount	**Allowance for ECL[1]**	Gross carrying/ nominal amount	Allowance for ECL[1]
	£'000	**£'000**	£'000	£'000
Loans and advances to customers at amortised cost	**3,479,622**	**(240,445)**	4,266,221	(127,756)
Loans and advances to banks at amortised cost	**1,613,658**	**–**	1,700,247	–
Other financial assets at amortised cost [3]	**72,036**	**–**	175,725	–
Total gross carrying amount on balance sheet	**5,165,316**	**(240,445)**	6,142,193	(127,756)
Loans and other credit related commitments	**11,607,912**	**(4,072)**	11,122,169	(639)
Total nominal amount off-balance sheet [2]	**11,607,912**	**(4,072)**	11,122,169	(639)
At 31 Dec	**16,773,228**	**(244,517)**	17,264,362	(128,395)

[1] *The total ECL is recognised in the loss allowance for the financial asset.*
[2] *Represents the maximum amount at risk should the contracts be fully drawn upon and clients default.*
[3] *Other financial assets at amortised cost includes cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.*

The following table provides an overview of the Entity's credit risk by stage and the associated ECL coverage. The financial assets recorded in each stage have the following characteristics:

- Stage 1: Unimpaired and without significant increase in credit risk on which a 12-month allowance for ECL is recognised.
- Stage 2: A significant increase in credit risk has been experienced since initial recognition on which a lifetime ECL is recognised.
- Stage 3: Objective evidence of impairment, and are therefore considered to be in default or otherwise credit-impaired on which a lifetime ECL is recognised.

Summary of credit risk by stage distribution and ECL coverage by industry sector

	Gross carrying/nominal amount			Allowance for ECL			ECL Coverage %		
	Stage 1	**Stage 2**	**Stage 3**	**Stage 1**	**Stage 2**	**Stage 3**	**Stage 1**	**Stage 2**	**Stage 3**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**%**	**%**	**%**
Loans and advances to customers at amortised cost	**2,687,049**	**720,137**	**72,437**	**(29,509)**	**(175,733)**	**(35,203)**	**(1)%**	**(24)%**	**(49)%**
Loans and advances to banks at amortised cost	**1,613,658**	**–**	**–**	**–**	**–**	**–**	**– %**	**– %**	**– %**
Other financial assets measured at amortised cost [1]	**72,036**	**–**	**–**	**–**	**–**	**–**	**– %**	**– %**	**– %**
Loan and other credit-related commitments	**11,531,860**	**46,125**	**29,927**	**(3,852)**	**(220)**	**–**	**– %**	**– %**	**– %**
At 31 Dec 2020	**15,904,603**	**766,262**	**102,364**	**(33,361)**	**(175,953)**	**(35,203)**	**– %**	**(23)%**	**(34)%**
Loans and advances to customers at amortised cost	3,536,903	659,355	69,963	(12,652)	(85,366)	(29,738)	– %	(13)%	(43)%
Loans and advances to banks at amortised cost	1,700,247	–	–	–	–	–	– %	– %	– %
Other financial assets measured at amortised cost [1]	175,725	–	–	–	–	–	– %	– %	– %
Loan and other credit-related commitments	11,041,637	52,824	27,708	(639)	–	–	– %	– %	– %
At 31 Dec 2019	16,454,512	712,179	97,671	(13,291)	(85,366)	(29,738)	– %	(12)%	(30)%

[1] *Other financial assets includes cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.*

Unless identified at an earlier stage, all financial assets are deemed to have suffered a significant increase in credit risk when they are 30 days past due ('DPD') and are transferred from stage 1 to stage 2. The following disclosure below presents the ageing of stage 2 financial assets. It distinguishes those assets that are classified as Stage 2 when they are less than 30 days past due (1-29 DPD) from those that are due to ageing and are more than 30 DPD (30 and >DPD). Past due financial instruments are those loans where customers have failed to make payments in accordance with the contractual terms of their facilities.

Stage 2 days past due analysis at 31 December 2020

	Gross carrying/nominal amount				Allowance for ECL				ECL coverage %			
	Stage 2	*Of which:*	*Of which:*	*Of which:*	Stage 2	*Of which:*	*Of which:*	*Of which:*	Stage 2	*Of which:*	*Of which:*	*Of which:*
		Up-to-date	1 to 29 DPD[1,2]	30 and > DPD[1,2]		Up-to-date	1 to 29 DPD[1,2]	30 and > DPD[1,2]		Up-to-date	1 to 29 DPD[1,2]	30 and > DPD[1,2]
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	%	%	%	%
Loans and advances to customers at amortised cost	720,137	689,613	18,466	12,057	(175,733)	(158,224)	(9,080)	(8,429)	(24.4)%	(22.9)%	(49.2)%	(69.9)%

1 Days past due ('DPD').

2 The days past due amounts presented above are on a contractual basis and include the benefit of any customer relief payment holidays granted

	Gross carrying/nominal amount				Allowance for ECL				ECL coverage %			
	Stage 2	*Of which:*	*Of which:*	*Of which:*	Stage 2	*Of which:*	*Of which:*	*Of which:*	Stage 2	*Of which:*	*Of which:*	*Of which:*
		Up-to-date	1 to 29 DPD[1]	30 and > DPD[1]		Up-to-date	1 to 29 DPD[1]	30 and > DPD[1]		Up-to-date	1 to 29 DPD[1]	30 and > DPD[1]
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	%	%	%	%
Loans and advances to customers at amortised cost	659,355	624,228	21,259	13,869	(85,366)	(73,204)	(5,491)	(6,671)	(12.9)	(11.7)	(25.8)	(48.1)

1 Days past due ('DPD').

Concentration of credit risk exposure

Concentrations of credit risk arise when a number of counterparties or exposures have comparable economic characteristics, or such counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors, so that their collective ability to meet contractual obligations is uniformly affected by changes in economic, political or other conditions.

Due to the retail-based nature of its lending activities, the Entity is not exposed to any significant concentration risk.

Concentration of exposures

The diversification of the Entity's lending portfolio and range of products ensures that there is no over dependence on any one segment to generate growth in 2020.

Loans and advances to customers and banks held at amortised cost

The table on page 44 analyses loans and advances to show any concentration of credit risk exposures.

Items in the course of collection from other banks

Settlement risk arises in any situations where a payment in cash, securities or equities is made with the expectation of a corresponding receipt of cash, securities or equities. Daily settlement limits are established for counterparties to cover the aggregate of transactions with each counterparty on any single day.

The Entity substantially mitigates settlement risk on many transactions, particularly those involving securities, by settling through assured payment systems, or on a delivery-versus-payment basis.

Measurement uncertainty and sensitivity analysis of ECL estimates

The recognition and measurement of expected credit loss ('ECL') involves the use of significant judgement and estimation. The Entity forms multiple economic scenarios based on economic forecasts, apply these assumptions to credit risk models to estimate future credit losses, and probability-weight the results to determine an unbiased ECL estimate. Management judgemental adjustments are used to address late-breaking events, data and model limitations, model deficiencies and expert credit judgements.

Methodology

Four economic scenarios have been used to capture the exceptional nature of the current economic environment and to articulate management's view of the range of potential outcomes. Scenarios produced to calculate ECL are aligned to HSBC Group's top and emerging risks. Three of these scenarios are drawn from consensus forecasts and distributional estimates. These include a Central scenario, a Downside and an Upside scenario that represent meaningfully different outcomes from the Central. The Central scenario is created using the average of a panel of external forecasters while consensus Upside and Downside scenarios are created with reference to distributions for select markets that capture forecasters views of the entire range of outcomes. Management has chosen to use a fourth scenario to represent their view of severe downside risks. The use of an additional scenario is in line with the HSBC Group's FEG methodology and has been regularly used over the course of 2020. Management may include additional scenarios if it feels that the consensus scenarios do not adequately capture the top and emerging risks. Unlike the consensus scenarios, these additional scenarios are driven by narrative assumptions, and may result in shocks that drive economic activity permanently away from trend.

Description of consensus economic scenarios

The economic assumptions presented in this section have been formed internally by the HSBC Group specifically for the purpose of calculating ECL.

The world economy experienced a deep economic shock in 2020, including that of the UK. As Covid-19 spread globally, the UK government and governments elsewhere sought to limit the human impact by imposing significant restrictions on mobility, in turn driving the deep falls in activity that were observed in the first half of the year. Restrictions were eased as cases declined in response to the initial measures, which supported an initial rebound in economic activity by the third quarter of 2020. This increase in mobility and emergence of the UK variant unfortunately led to renewed transmission of the virus in December 2020, placing the UK healthcare system under significant burden, leading governments to re-impose restrictions on mobility and causing economic activity to decline once more.

Economic forecasts are subject to a high degree of uncertainty in the current environment. Limitations of forecasts and economic models require a greater reliance on management judgement in addressing both the error inherent in economic forecasts and in assessing associated ECL outcomes. The scenarios used to calculate ECL in the Annual Report and Financial Statement 2020 are described below.

The consensus Central scenario

The Central scenario features an improvement in economic growth in 2021 as activity and employment gradually return to the levels experienced prior to the outbreak of Covid-19.

Despite the sharp contraction in activity, government fiscal support played a crucial role in averting significant financial distress. At the same time, the UK government and the Bank of England implemented a variety of measures, which included lowering the main policy interest rate, implementing emergency support measures for funding markets, and either restarting or increasing quantitative easing programmes in order to support economies and the financial system. The UK government and the Bank of England are expected to continue to work together to ensure that households and firms receive an appropriate level of financial support until restrictions on economic activity and mobility can be materially eased. Such support intends to ensure that labour and housing markets do not experience abrupt, negative corrections and also intends to limit the extent of long term structural damage to the UK economy.

The Central scenario incorporates expectations that the UK government will be successful in the implementation of its large vaccination programme, first by vaccinating critical groups and then increasing coverage to include the wider population. The deployment of mass vaccination programmes marks a significant step forward in combating the virus and will ease the burden on the UK's National Healthcare Service over the course of 2021.

The key features of the Central scenario are:

• Growth in UK GDP in 2021. Economic activity will recover, supported by a successful rollout of the vaccination programme. It is expected that the vaccination programme, coupled with effective non-pharmacological measures to contain the virus ('track and trace' systems and restrictions to mobility) to lead to a significant decline in infections by the end of 2021.

• Government support programmes will continue to provide support to households and businesses in 2021. A gradual reversion of the unemployment rate to pre-crisis levels over the course of the projection period as a result of economic recovery and due to the orderly withdrawal of fiscal support is expected.

• Inflation will converge towards target.

• Bank of England base rate will remain at current levels for an extended period and will increase very modestly towards the end of our projection period. The Bank of England will continue to provide assistance through their asset purchase programmes as needed.

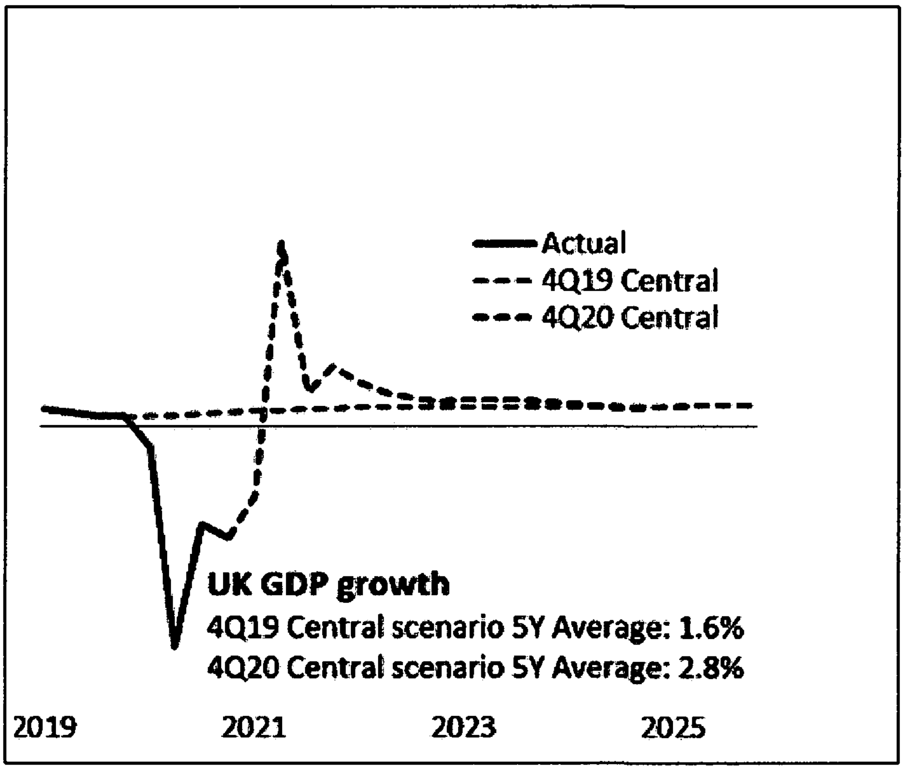
The following table describes key macroeconomic variables and the probabilities assigned in the consensus Central scenario applied at 31 December 2020 and 31 December 2019.

Central scenario	Average 2021 Q1-2025 Q4	Average 2020-2024
	UK	UK
GDP growth rate (%)	**2.8**	1.6
Inflation (%)	**N/A**	2.0
Unemployment (%)	**5.6**	4.4
Short term interest rate (%)	**0.2**	0.6
10 year treasury bond yields (%)	**N/A**	1.7
House price growth (%)	**1.9**	3.0
Equity price growth (%)	**N/A**	2.8
Probability (%)	**40**	55

A brief graphical comparative with the Central scenario at the end of 2019 reveals the extent of economic dislocation that occurred in 2020 and the impact this has had on central projections made at the end of the year.

The emergent nature of the Covid-19 outbreak at the end of 2019 meant that, consistent with other banks, the Entity's Central scenario did not, on a forward-looking basis, consider the impact of the virus. The Entity's Central scenario at the 2019 year-end projected moderate growth over a five-year horizon, with strong prospects for employment and a gradual increase in policy interest rates by the Bank of England. The onset of the virus led to a fundamental reassessment of our central forecast and the distribution of risks over the course of 2020. The Central scenario at the end of 2020, as described above, is based on assumptions that are considerably different.

GDP growth: Comparison



The consensus Upside scenario

Compared with the consensus Central scenario, the consensus Upside scenario features a faster recovery in economic activity during the first two years, before converging to long-run trends. The scenario is consistent with a number of key upside risk themes. These include the orderly and rapid global abatement of Covid-19 via successful containment and prompt deployment of a vaccine; continued support from fiscal and monetary policy and smooth relations between the UK and the EU which enables the two parties to swiftly reach a comprehensive agreement on trade and services.

The following table describes key macroeconomic variables and the probabilities assigned in the consensus Upside scenario applied at 31 December 2020 and 31 December 2019.

Upside scenario	Best outcome 2021 Q1-2025 Q4	Average 2020-2024
	UK	UK
GDP growth rate (%)	**19.9 (2Q21)**	2.1
Inflation (%)	**N/A**	2.4
Unemployment (%)	**3.7 (4Q22)**	4.0
Short term interest rate (%)	**0.1 (2Q22)**	0.6
10 year treasury bond yields (%)	**N/A**	1.7
House price growth (%)	**6.9 (4Q22)**	4.4
Equity price growth (%)	**N/A**	4.4
Probability (%)	**5**	10

Note: extreme point in the consensus Upside is 'best outcome' in the scenario, i.e. highest GDP growth, lowest unemployment rate etc, in first two years of the scenario.

The Downside scenarios

2021 is expected to be a year of economic recovery, but the progression and management of the pandemic presents a key risk to global growth. A new and more contagious strain of the virus increased the transmission rate in the UK and resulted in stringent restrictions to mobility towards the year end. This viral strain observed in the UK, together with aggressive strains observed in other countries including South Africa and Brazil, introduce the risk that transmission may increase significantly in 2021 and also raise concerns around the efficacy of vaccines as the virus mutates. The UK may keep significant restrictions to mobility in place for an extended period of time and at least until critical segments of the population can be vaccinated. Further risks to international travel also arise.

A number of vaccines have been developed and approved for use at a rapid pace and plans to vaccinate significant proportions of the UK populations in 2021 are a clear positive for economic recovery. While the Entity expect the vaccination programme to be successful, the government and National Health Service face challenges that could affect the speed and spread of vaccinations. These challenges include the logistics of vaccinating a significant proportion of the population within a limited timeframe. Supply challenges could affect the pace of roll-out, 'vaccine wars' could disrupt supply and the efficacy of vaccines is yet to be determined. Government support programmes in 2020 was supported by accommodative actions taken by the Bank of England. These measures by the UK government and the Bank of England have provided households and firms with significant support. An inability or unwillingness to continue with such support or the untimely withdrawal of support present a downside risk to growth.

The consensus Downside scenario

In the consensus Downside scenario, economic recovery is considerably weaker compared with the Central scenario. GDP growth remains weak, unemployment rates stay elevated and asset and commodity prices fall before gradually recovering towards their long-run trends.

The scenario is consistent with the key downside risks articulated above. Further outbreaks of Covid-19, coupled with delays in the vaccination programme, lead to longer-lasting restrictions on economic activity. Other global risks also increase and drive increased risk-aversion in asset markets.

The following table describes key macroeconomic variables and the probabilities assigned in the Consensus Downside scenario applied at 31 December 2020 and 31 December 2019.

Downside scenario	Worst outcome 2021 Q1-2025 Q4
	UK
GDP growth rate (%)	**(7.6) (1Q21)**
Inflation (%)	**N/A**
Unemployment (%)	**9.4 (4Q21)**
Short term interest rate (%)	**0.1 (1Q21)**
10 year treasury bond yields (%)	**N/A**
House price growth (%)	**(10.8) (4Q21)**
Equity price growth (%)	**N/A**
Probability (%)	**40**

Note: extreme point in the consensus Downside is 'worst outcome' in the scenario, i.e. lowest GDP growth, highest unemployment rate etc, in first two years of the scenario (2021Q1-2022Q4).

Additional Downside scenarios for the UK

An additional Downside scenario that features a global recession has been created to reflect management's view of severe risks. Infections rise in 2021 and setbacks to vaccine programmes imply that successful roll-out of vaccines only occurs towards the end of 2021 and it takes until the end of 2022 for the pandemic to come to an end. The UK government and the Bank of England are unable to significantly increase fiscal and monetary programmes, which results in abrupt corrections in labour and asset markets.

The table below describes key macro-economic variables and the probabilities for each of the Alternative Downside scenarios applied at 31 December 2020 and 31 December 2019:

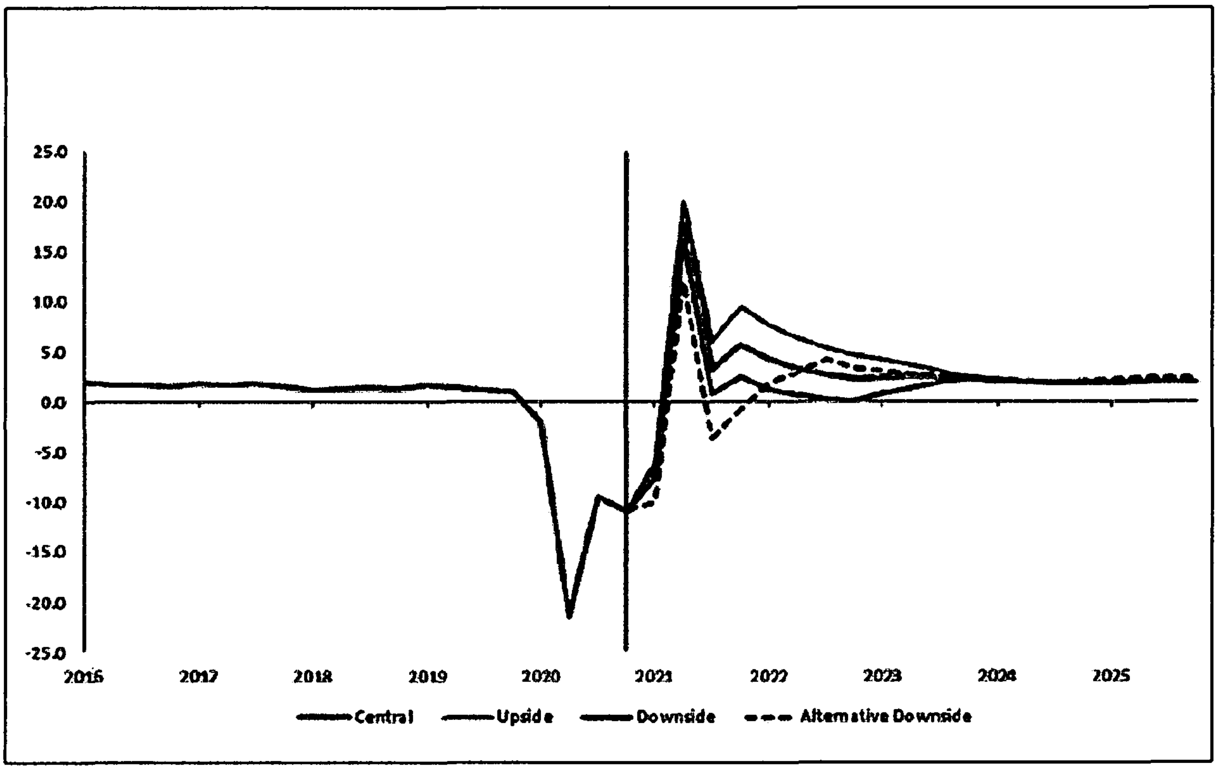
Additional Downside scenario worst outcome	Worst outcome 2021 Q1-2025 Q4
GDP growth rate (%)	(10.1) (1Q21)
Unemployment (%)	9.8 (3Q21)
Short term interest rate (%)	0.8 (2Q21)
House price growth (%)	14.5 (4Q21)
Probability (%)	15

In considering economic uncertainty and assigning probabilities to scenarios, management has considered both global and UK specific factors. This has led management to assigning scenario probabilities that are tailored to its view of uncertainty in individual markets.

To inform its view, management has considered trends in the progression of the virus in the UK, the expected reach and efficacy of vaccine roll-outs over the course of 2021, the size and effectiveness of future government support schemes and the connectivity with other countries. Management has also been guided by the actual response to the Covid-19 outbreak and by the economic experience across the UK in 2020.

The UK faces significant economic uncertainty. In the UK, the discovery of a more infectious strain of the virus and subsequent national restrictions on activity imposed before the end of the year has resulted in considerable uncertainty in the economic outlook. Given these considerations, the Central and the consensus Downside scenario for the UK have each been assigned 40% probability. This reflects management's view that as a result of elevated uncertainty, the Central scenario cannot be viewed as the single most likely outcome. The additional Downside scenario has been assigned 15% probability to reflect the view that the balance of risks is weighted to the downside, with the remaining 5% probability weighted to the consensus Upside scenario.

The following graphs show the historical and forecasted GDP growth rate for the various economic scenarios.



In comparison, at 31 December 2019 three Alternative Downside scenarios were maintained reflecting management's view of the distribution of economic risks at that time. These scenarios reflected management's judgement that the consensus distribution did not adequately reflect the risks that stemmed from the UK's departure from the EU on 31 January 2020. The emergent nature of the Covid-19 outbreak at the end of 2019 meant that its impacts was not considered in any of the Alternative Downside Scenarios. The three scenarios were UK Alternative Downside 1, which reflected a long-lasting recession with a weak recovery (probability weighting 25%), UK Alternative Downside 2, a tail risk scenario involving a steep depreciation in sterling and an increase in inflation (probability weighting 5%), and UK Alternative Downside 3, a tail risk which considered the impacts of the other 2 scenarios over a longer period of time (probability weighting 5%).

Critical accounting estimates and judgements

The calculation of ECL under IFRS 9 involves significant judgements, assumptions and estimates. The level of estimation uncertainty and judgement has increased during 2020 as a result of the economic effects of the Covid-19 outbreak, including significant judgements relating to:

- the selection and weighting of economic scenarios, given rapidly changing economic conditions in an unprecedented manner, uncertainty as to the effect of government and the Bank of England support measures designed to alleviate adverse economic impacts, and a wider distribution of economic forecasts than before the pandemic. The key judgements are the length of time over which the economic effects of the pandemic will occur, the speed and shape of recovery. The main factors include the effectiveness of pandemic containment measures, the pace of roll-out and effectiveness of vaccines, and the emergence of new variants of the virus, plus a range of geopolitical uncertainties, which together represent a very high degree of estimation uncertainty, particularly in assessing Downside scenarios;
- estimating the economic effects of those scenarios on ECL, where there is no observable historical trend that can be reflected in the models that will accurately represent the effects of the economic changes of the severity and speed brought about by the Covid-19 outbreak. Modelled assumptions and linkages between economic factors and credit losses may underestimate or overestimate ECL in these conditions, and there is significant uncertainty in the estimation of parameters such as loss severity; and
- the identification of customers experiencing significant increases in credit risk and credit impairment, particularly where those customers have accepted payment deferrals and other reliefs designed to address short-term liquidity issues given muted default experience to date. The use of segmentation techniques for indicators of significant increases in credit risk involves significant estimation uncertainty.

How economic scenarios are reflected in the calculation of ECL

We have developed and implemented a globally consistent methodology for incorporating forecasts of economic conditions into ECL estimates. The impact of economic scenarios on PD is modelled at a portfolio level. Historical relationships between observed default rates and macroeconomic variables are integrated into IFRS 9 ECL estimates by using economic response models. The impact of these scenarios on PD is modelled over a period equal to the remaining maturity of underlying asset or assets. These models are based largely on historical observations and correlations with default rates. Management judgemental adjustments are described below.

Management judgemental adjustments

In the context of IFRS 9, management judgemental adjustments are short-term increases or decreases to the ECL at either a customer or portfolio level to account for late breaking events, model and data limitations and deficiencies, and expert credit judgement applied following management review and challenge.

The most severe projections at 31 December 2020 of macroeconomic variables are outside the historical observations on which IFRS 9 models have been built and calibrated to operate.

Moreover, the complexities of governmental support programmes, the impacts on customer behaviours and the unpredictable pathways of the pandemic have never been modelled. Consequently, the Entity's IFRS 9 models, in some cases, generate outputs that appear overly sensitive when compared with other economic and credit metrics. Governmental support programmes and customer payment reliefs have dislocated the correlation between economic conditions and defaults on which models are based. Management judgemental adjustments are required to ensure that an appropriate amount of ECL impairment is recognised.

The Entity has internal governance in place to regularly monitor management judgemental adjustments and, where possible, to reduce the reliance on these through model recalibration or redevelopment, as appropriate. During 2020 the composition of modelled ECL and management judgemental adjustments changed significantly, reflecting the path of the pandemic, containment efforts and government support measures, and this is expected to continue to be the case until economic conditions improve. Wider-ranging model changes will take time to develop and need more real data on which models can be developed. Models will be revisited over time once the full impacts of Covid-19 are observed. Therefore, we anticipate significant management judgemental adjustments for the foreseeable future. Management judgemental adjustments made in estimating the reported ECL at 31 December 2020 are set out in the following table. The table includes adjustments in relation to data and model limitations resulting from the pandemic, and as a result of the regular process of model development and implementation. It shows the adjustments applicable to the scenario-weighted ECL numbers. Adjustments in relation to Downside scenarios are more significant, as results are subject to greater uncertainty.

Management judgemental adjustments to ECL[1]	Total
	£m
Lending PD adjustments	(113)
Model default suppression adjustment	190
Other lending adjustments	(3)
Total	**74**

1. *Management judgemental adjustments presented in the table reflect increases or (decreases) to ECL,respectively.*

During 2020, management judgemental adjustments reflected the volatile economic conditions associated with the Covid-19 pandemic.

At 31 December 2020, management judgemental adjustments led to an ECL increase of £74m, primarily from additional ECL of £190m to reflect adjustments to the timing of default which has been delayed by government support and customer relief measures on potential defaults, notably through delaying an increase in unemployment. The model default suppression adjustment was applied as defaults remain temporarily suppressed due to government support and customer relief programmes which have supported stabilised portfolio performance. Models are reliant on the assumption that as macroeconomic conditions deteriorate, defaults will crystallise. This adjustment aligns the increase in default due to changes in economic conditions to the period of time when defaults are expected to be observed. The model default suppression adjustment will be monitored and updated prospectively to ensure appropriate alignment with expected performance taking into consideration the levels and timing of government support and customer relief programmes.

This was partially offset by adjustments to lending PD outputs of £(113)m for unintuitive model responses, primarily where economic forecasts were beyond the bounds of the model development period. The Downside unemployment forecasts were outside the historical bounds on which the model was developed resulting in unintuitive levels of PD. This adjustment reduced the sensitivity of PD in the Downside scenarios to better align with the historical correlation between changes in levels of unemployment and defaults. Other lending adjustments of £(3)m address areas such as customer relief and data limitations.

Economic scenarios sensitivity analysis of ECL estimates

Management considered the sensitivity of the ECL outcome against the economic forecasts as part of the ECL governance process by recalculating the ECL under each scenario described above for selected portfolios, applying a 100% weighting to each scenario in turn. The weighting is reflected in both the determination of a significant increase in credit risk and the measurement of the resulting ECL.

The ECL calculated for the Upside and Downside scenarios should not be taken to represent the upper and lower limits of possible actual ECL outcomes. The impact of defaults that might occur in future under different economic scenarios is captured by recalculating ECL for loans in stages 1 and 2 at the balance sheet date. The population of stage 3 loans (in default) at the balance sheet date is unchanged in these sensitivity calculations. Stage 3 ECL would only be sensitive to changes in forecasts of future economic conditions if the LGD of a particular portfolio was sensitive to these changes.

There is a particularly high degree of estimation uncertainty in numbers representing tail risk scenarios when assigned a 100% weighting, and an indicative range is provided for the UK tail risk sensitivity analysis.

The sensitivity analysis is stated inclusive of management judgemental adjustments, as appropriate to each scenario.

IFRS 9 ECL sensitivity to future economic conditions[1]	**2,020**	2019
	UK	UK
	£m	£m
ECL of loans and advances to customers at 31 December 2020 [2]		
Reported ECL (£m)	**245**	128
Consensus Scenarios		
Central scenario	**213**	97
Upside scenario	**140**	83
Downside scenario	**257**	123
Alternative Scenarios		
- UK alternative Downside scenario[3]	**308**	174
- Tail risk scenarios (UK alternative Downside Scenarios 2 and 3)	**N/A**	269 - 224

1 ECL sensitivities exclude portfolios utilising less complex modelling approaches.

2 ECL sensitivity includes only on-balance sheet financial instruments to which IFRS 9 impairment requirements are applied.

3 The alternative downside scenario was used for 2019.

At 31 December 2020, the most significant level of ECL sensitivity was observed.

Mortgages reflected the lowest level of ECL sensitivity across most markets as collateral values remain resilient. Credit cards and other unsecured lending are more sensitive to economic forecasts, which have deteriorated in 2020 due to the Covid-19 pandemic.

Reconciliation of changes in gross carrying/nominal amount and allowances for loans and advances to banks and customers including loan commitments

The following disclosure provides a reconciliation by stage of the Entity's gross carrying/nominal amount and allowances for loans and advances to banks and customers, including loan commitments.

The transfers of financial instruments represents the impact of stage transfers upon the gross carrying/nominal amount and associated allowance for ECL. The net remeasurement of ECL arising from stage transfers represents the increase or decrease in ECL due to these transfers, for example, moving from a 12-month (stage 1) to a lifetime (stage 2) ECL measurement basis. Net remeasurement excludes the underlying PD movements of the financial instruments transferring stage. This is captured, along with other credit quality movements in the 'changes to risk parameters – credit quality' line item.

The 'new financial assets originated or purchased', 'changes to risk parameters - further lending/repayments' and 'assets derecognised (including final repayments)' represent the gross carrying/nominal amount and associated allowance ECL impact from volume movements within the Entity's lending portfolio.

	Non credit - impaired				Credit impaired		Total	
	Stage 1		Stage 2		Stage 3			
	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL	Gross carrying/ nominal amount	Allowance for ECL
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
At 1 Jan 2020	**16,278,785**	**(13,291)**	**712,180**	**(85,366)**	**97,672**	**(29,738)**	**17,088,637**	**(128,395)**
Transfer of financial instruments							**115**	**1**
- transfers from stage 1 to stage 2	**(241,388)**	**1,784**	**241,388**	**(1,784)**	**–**	**–**	**–**	**–**
- transfers from stage 2 to stage 1	**262,915**	**(11,886)**	**(262,915)**	**11,886**	**–**	**–**	**–**	**–**
- transfers to stage 3	**–**	**–**	**(10,169)**	**5,063**	**10,284**	**(5,063)**	**115**	**–**
- transfers from stage 3	**3**	**(2)**	**699**	**(575)**	**(702)**	**578**	**–**	**1**
Net remeasurement of ECL arising from transfer of stage	**–**	**5,778**	**–**	**(2,563)**	**–**	**–**	**–**	**3,215**
New financial assets originated or purchased	**2,018,158**	**(23,743)**	**–**	**–**	**–**	**–**	**2,018,158**	**(23,743)**
Changes to risk parameters- further lending/ repayments	**(656,307)**	**3,020**	**85,079**	**(18,643)**	**51,289**	**(9,001)**	**(519,939)**	**(24,624)**
Changes to risk parameters (credit quality)	**–**	**(15,589)**	**–**	**(83,972)**	**–**	**(48,157)**	**–**	**(147,718)**
Asset derecognised (including final repayments)	**(1,829,600)**	**20,568**	**–**	**–**	**–**	**–**	**(1,829,600)**	**20,568**
Assets written off	**–**	**–**	**–**	**–**	**(56,179)**	**56,179**	**(56,179)**	**56,179**
At 31 Dec 2020	**15,832,566**	**(33,361)**	**766,262**	**(175,954)**	**102,364**	**(35,202)**	**16,701,307**	**(244,516)**
ECL release/(charge) for the period		**(9,966)**		**(105,178)**		**(57,158)**		**(172,302)**
Recoveries		**–**		**–**		**16,454**		**16,454**
Total change in ECL for the period		**(9,966)**		**(105,178)**		**(40,704)**		**(155,848)**
At 1 Jan 2019	**16,287,578**	**(12,822)**	**484,540**	**(58,483)**	**80,421**	**(10,892)**	**16,852,539**	**(82,197)**
Transfer of financial instruments							–	–
- transfers from stage 1 to stage 2	(183,957)	1,517	183,957	(1,517)	–	–	–	–
- transfers from stage 2 to stage 1	83,204	(5,242)	(83,204)	5,242	–	–	–	–
- transfers to stage 3	(140)	3	(20,288)	4,299	20,428	(4,302)	–	–
- transfers from stage 3	41	(33)	6,833	(380)	(6,873)	413	–	–
Net remeasurement of ECL arising from transfer of stage	–	3,183	–	(4,749)	–	(1)	–	(1,567)
New financial assets originated or purchased	1,012,896	(4,348)	–	–	–	–	1,012,896	(4,348)
Net new and further lending/repayments	(514,348)	1,294	140,342	(5,003)	42,596	(9,900)	(331,410)	(13,609)
Changes to risk parameters - credit quality	–	1,490	–	(24,774)	–	(43,955)	–	(67,240)
Asset derecognised (including final repayments)	(406,488)	1,667	–	–	–	–	(406,488)	1,667
Assets written off	–	–	–	–	(38,899)	38,899	(38,899)	38,899
At 31 Dec 2019	**16,278,785**	**(13,291)**	**712,180**	**(85,366)**	**97,672**	**(29,738)**	**17,088,638**	**(128,395)**
ECL release/(charge) for the period		3,286		(34,526)		(53,856)		(85,097)
Recoveries		–		–		14,808		14,808
Total change in ECL for the period		3,286		(34,526)		(39,048)		(70,289)

1 For the purposes of this disclosure, gross carrying value is defined as the amortised cost of a financial asset before adjusting for any loss allowance. The reconciliation includes loans and advances to other HSBC Group companies. As at 31 December 2020, these amounted to £1.6m (2019: £1.7m) and were classified as stage 1 with no ECL. The reconciliation excludes other financial assets measured at amortised cost. As at 31 December 2020, these amounted to £72m (2019: £175m) and were classified as Stage 1 with no ECL.

The contractual amount outstanding of financial assets written off during the period that are still subject to enforcement activities amounted to £74k.

Credit quality

Credit quality of financial instruments

The Entity assesses the credit quality of all financial instruments that are subject to credit risk. The credit quality of financial instruments is a point-in-time assessment of the PD of financial instruments, whereas stages 1 and 2 are determined based on relative deterioration of credit quality since initial recognition.

The five credit quality classifications defined below each encompass a range of granular internal credit rating grades assigned to the lending business and the external ratings attributed by external agencies to debt securities, as shown in the table below.

Credit quality classification

	Debt Securities and other bills	Lending	
Quality classification	**External credit rating**	**Internal credit rating**	**12-month probability-weighted PD %1**
Strong	**A- and above**	**Band 1 and 2**	**0.000-0.500**
Good	**BBB+ to BBB-**	**Band 3**	**0.501-1.500**
Satisfactory	**BB+ to B and unrated**	**Band 4 and 5**	**1.501-20.000**
Sub-standard	**B- to C**	**Band 6**	**20.001-99.999**
Credit-impaired	**Default**	**Band 7**	**100.000**

1 12-month point-in-time probability-weighted probability of default ('PD')

Quality classification definitions

- 'Strong' exposures demonstrate a strong capacity to meet financial commitments, with negligible or low probability of default and/or low levels of expected loss.
- 'Good' exposures require closer monitoring and demonstrate a good capacity to meet financial commitments, with low default risk.
- 'Satisfactory' exposures require closer monitoring and demonstrate an average-to-fair capacity to meet financial commitments, with moderate default risk.
- 'Sub-standard' exposures require varying degrees of special attention and default risk is of greater concern.
- 'Credit-impaired' exposures have been assessed as impaired.

Distribution of financial instruments by credit quality

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Substandard	Credit impaired	Total	Allowance provision for ECL	Net
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Loans and advances to banks	**1,613,658**	–	–	–	–	**1,613,658**	–	**1,613,658**
Loans and advances to customers	**1,136,097**	**709,034**	**1,373,510**	**188,543**	**72,437**	**3,479,622**	**(240,445)**	**3,239,177**
Other financial assets held at amortised cost [1]	**72,036**	–	–	–	–	**72,036**	–	**72,036**
At 31 Dec 2020	**2,821,791**	**709,034**	**1,373,510**	**188,543**	**72,437**	**5,165,316**	**(240,445)**	**4,924,871**
Loan and other credit related commitments for loans and advances to customers	**11,030,913**	**379,518**	**162,005**	**5,549**	**29,927**	**11,607,912**	**(4,072)**	**11,603,840**
Loans and advances to banks	1,700,247	–	–	–	–	1,700,247	–	1,700,247
Loans and advances to customers	2,273,391	1,059,257	831,491	32,119	69,963	4,266,221	(127,756)	4,138,465
Other financial assets held at amortised cost [1]	175,725	–	–	–	–	175,725	–	175,725
At 31 Dec 2019	4,149,363	1,059,257	831,491	32,119	69,963	6,142,193	(127,756)	6,014,437
Loan and other credit related commitments for loans and advances to customers	9,980,533	920,333	186,757	6,838	27,708	11,122,169	(639)	11,121,530

[1] *Other financial assets held at amortised cost includes cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.*

[2] *For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance.*

Distribution of financial instruments to which the impairment requirements of IFRS 9 are applied by credit quality stage allocation

	Gross carrying/notional amount							
	Strong	Good	Satisfactory	Substandard	Credit impaired	Total	Allowance provision for ECL	Net
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Loans and advances to banks at amortised cost	**1,613,658**	**–**	**–**	**–**	**–**	**1,613,658**	**–**	**1,613,658**
- stage 1	**1,613,658**	**–**	**–**	**–**	**–**	**1,613,658**	**–**	**1,613,658**
Loans and advances to customers at amortised cost	**1,136,097**	**709,034**	**1,373,510**	**188,543**	**72,437**	**3,479,622**	**(240,445)**	**3,239,177**
- stage 1	**1,136,097**	**709,034**	**841,917**	**–**	**–**	**2,687,048**	**(29,509)**	**2,657,538**
- stage 2	**–**	**–**	**531,593**	**188,543**	**–**	**720,137**	**(175,733)**	**544,404**
- stage 3	**–**	**–**	**–**	**–**	**72,437**	**72,437**	**(35,203)**	**37,235**
Other financial assets measured at amortised cost [1]	**72,036**	**–**	**–**	**–**	**–**	**72,036**	**–**	**72,036**
- stage 1	**72,036**	**–**	**–**	**–**	**–**	**72,036**	**–**	**72,036**
Loans and other credit related commitments	**11,030,914**	**379,518**	**162,005**	**5,549**	**29,927**	**11,607,912**	**(4,072)**	**11,603,840**
- stage 1	**11,030,914**	**379,518**	**121,429**	**–**	**–**	**11,531,860**	**(3,852)**	**11,528,008**
- stage 2	**–**	**–**	**40,576**	**5,549**	**–**	**46,125**	**(220)**	**45,905**
- stage 3	**–**	**–**	**–**	**–**	**29,927**	**29,927**	**–**	**29,927**
At 31 Dec 2020	**13,852,705**	**1,088,551**	**1,535,515**	**194,093**	**102,364**	**16,773,228**	**(244,517)**	**16,528,711**

Loans and advances to banks at amortised cost	1,700,247	–	–	–	–	1,700,247	–	1,700,247
- stage 1	1,700,247	–	–	–	–	1,700,247	–	1,700,247
Loans and advances to customers at amortised cost	2,273,391	1,059,257	831,491	32,119	69,963	4,266,221	(127,756)	4,138,465
- stage 1	2,273,391	1,059,257	204,255	–	–	3,536,902	(12,652)	3,524,251
- stage 2	–	–	627,236	32,119	–	659,355	(85,366)	573,989
- stage 3	–	–	–	–	69,963	69,963	(29,738)	40,225
Other financial assets measured at amortised cost [1]	175,725	–	–	–	–	175,725	–	175,725
- stage 1	175,725	–	–	–	–	175,725	–	175,725
Loans and other credit related commitments	9,980,533	920,333	186,757	6,838	27,708	11,122,169	(639)	11,121,530
- stage 1	9,980,533	920,333	140,770	–	–	11,041,636	(639)	11,040,997
- stage 2	–	–	45,987	6,838	–	52,825	–	52,825
- stage 3	–	–	–	–	27,708	27,708	–	27,708
At 31 Dec 2019	14,129,896	1,979,589	1,018,249	38,957	97,671	17,264,362	(128,395)	17,135,967

[1] *Other financial assets measured at amortised cost include cash and balances at central banks, items in the course of collection from other banks and prepayments and accrued income.*

[2] *For the purposes of this disclosure gross carrying value is defined as the amortised cost of a financial asset, before adjusting for any loss allowance.*

Credit impaired loans

The Entity determines that a financial instrument is credit-impaired and in stage 3 by considering relevant objective evidence, primarily whether:

- contractual payments of either principal or interest are past due for more than 90 days;
- there are other indications that the borrower is unlikely to pay such as that a concession has been granted to the borrower for economic or legal reasons relating to the borrower's financial condition; and
- the loan is otherwise considered to be in default. If such unlikeliness to pay is not identified at an earlier stage, it is deemed to occur when an exposure is 90 days past due, even where regulatory rules permit default to be defined based on 180 days past due. Therefore the definitions of credit-impaired and default are aligned as far as possible so that stage 3 represents all loans which are considered defaulted or otherwise credit impaired.

Renegotiated loans and forbearance

Where customers are in (or approaching) financial difficulty, due consideration is given to provide assistance to customers (either on a temporary or permanent basis) to help them meet the contractual commitments relating to their account. The Entity's policy provides guidance on when customers are considered to be in financial difficulty and the various forbearance tools that are available to assist them. It is recognised that customers find themselves in financial difficulties as a result of many different situations and Collections staff speaking with customers will often be best placed to understand the individual circumstances and needs of specific customers. Prior to agreeing a forbearance an appropriate level of assessment on a customer's affordability is completed to ensure any solution agreed with the customer is sustainable.

The following table shows the gross carrying amounts of the Entity's holdings of renegotiated loans and advances to customers by stage. Renegotiated loans are deemed to remain credit-impaired until repayment or derecognition. Mandatory and general offer loan modifications that are not borrower-specific, for example market-wide customer relief programmes, have not been classified as renegotiated loans.

	At 31 Dec 2020				At 31 Dec 2019			
	stage 1	**stage 2**	**stage 3**	**Total**	stage 1	stage 2	stage 3	Total
	£'000	**£'000**	**£'000**	**£'000**	£'000	£'000	£'000	£'000
Renegotiated loans	**–**	**–**	**26,526**	**26,526**	–	–	25,878	25,878
Impairment allowance on renegotiated loans	**–**	**–**	**–**	**(13,608)**	–	–	–	(4,579)
Renegotiated loans and advances as % of total gross loans (%)	**–**	**–**	**–**	**0.8**	–	–	–	0.6

Customer relief programmes

In response to the Covid-19 outbreak, governments and regulators around the world have introduced a number of support measures for personal customers. The following table presents the number of personal accounts and the associated drawn loan values of customers under these schemes and M&S Bank specific measures at 31 December 2020.

		At 31 Dec 2020
Personal lending		
Personal lending market-wide schemes		
Number of accounts granted mortgage customer relief	**000s**	**0.21**
Drawn loan value of customers granted mortgage customer relief	**£m**	**29**
Number of accounts granted other personal lending customer relief	**000s**	**38**
Drawn loan value of customers granted other personal lending customer relief	**£m**	**212**
Market-wide schemes and bank-specfic measure mortgage relief as a proportion of total mortgage loans and advances	**%**	**–**
Market-wide schemes and bank-specfic measures other personal lending relief as a proportion of total other personal lending loans and advances	**%**	**–**

The initial granting of customer relief does not automatically trigger a migration to Stage 2 or 3. However information provided by payment deferrals are considered in the context of other reasonable and supportable information, as part of the overall assessment for significant increase in credit risk ('SICR') and for credit impairment, to identify loans for which lifetime ECL is appropriate. An extension in payment deferral does not automatically result in Stage 2 or Stage 3. The key accounting and credit risk judgement is whether the economic effects of Covid-19 on the customer are likely to be temporary, so that they do not result in an SICR over the lifetime of the loan, and do not indicate that a concession is being made in respect of financial difficulty that would be consistent with Stage 3. The following narrative provides further details on the schemes offered:

Market-wide schemes

Personal Lending

Mortgages

Customer relief granted on mortgages primarily consists of payment holidays or partial payment deferrals. Relief is offered for an initial period of three months and can be further extended for up to a further three months in certain circumstances. No payment is required from the customer during this period (though with a partial payment deferral the customer has expressed a desire to make a contribution) and interest continues to be charged as usual. The customers' arrears status is not worsened from utilisation of these schemes.

Other personal lending payment holidays

Customer relief is granted for an initial period of three months and can be extended for a further three months. The maximum relief value is up to the due payment amount during the period.

Liquidity risk management

Liquidity risk is the risk that the Entity does not have sufficient financial resources to meet obligations as they fall due or will have access to such resources only at an excessive cost. The risk arises from mismatches in the timing of cash flows.

The Entity is part of the Domestic Liquidity Sub-group ('Liquidity Group') of HSBC UK Bank plc and therefore part of the internal liquidity control and management structure of HSBC UK Bank plc. The Entity's liquidity position is managed as part of the HSBC Bank UK plc Liquidity Group, under which members agree to provide liquidity support when necessary.

The following is an analysis of undiscounted cash flows payable under various financial liabilities by remaining contractual maturities at the balance sheet date:

	On Demand	Due within 3 months	Due between 3-12 months	Due between 1-5 years	Due after 5 years	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Deposits by banks	**34**	**479,397**	**709,374**	**1,102,870**	**–**	**2,291,675**
Customer accounts	**2,178,589**	**–**	**–**	**–**	**–**	**2,178,589**
Accruals, deferred income, leases and other liabilities	**–**	**3,523**	**7,444**	**6,043**	**106**	**17,116**
Current tax liabilities	**–**	**–**	**–**	**–**	**–**	**–**
Subordinated liabilities	**–**	**739**	**2,264**	**12,026**	**97,664**	**112,693**
Loan commitments	**11,607,912**	**–**	**–**	**–**	**–**	**11,607,912**
Provisions	**–**	**25,610**	**6,711**	**23,285**	**–**	**55,606**
At 31 Dec 2020	**13,786,535**	**509,269**	**725,793**	**1,144,224**	**97,770**	**16,263,591**
Deposits by banks	–	713,248	1,032,564	1,363,272	–	3,109,084
Customer accounts	2,123,314	–	–	–	–	2,123,314
Accruals, deferred income, leases and other liabilities	–	965	2,922	15,451	–	19,338
Current tax liabilities	–	31,066	–	–	–	31,066
Subordinated liabilities	–	202	–	–	95,000	95,202
Loan commitments	11,122,169	–	–	–	–	11,122,169
Provisions	–	52,049	101,864	26,403	–	180,316
At 31 Dec 2019	13,245,483	797,530	1,137,350	1,405,126	95,000	16,680,489

Market risk management

Market risk is the risk that movements in market factors including interest rates and foreign exchange rates will impact the Entity's income or the value of its portfolios.

The Entity's objective is to manage and control market rate exposures while maintaining a market profile consistent with its risk appetite.

Interest rate risk

Interest rate risk is managed by matching the re-price maturity profile of assets and liabilities using a behavioural basis. Maturity mismatches are managed through deposits and borrowings to ensure the financial exposure of the Entity within approved limits.

	Not more than 3 months	Between 3 and 6 months	Between 6 months and 1 year	Between 1 and 5 years	More than 5 years	Non-interest bearing	Total
At 31 Dec 2020	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Assets							
Loans and advances to banks	**1,378,658**	**60,000**	**70,000**	**105,000**	**–**	**–**	**1,613,658**
Loans and advances to customers	**714,306**	**673,844**	**340,025**	**1,461,544**	**14,315**	**35,143**	**3,239,177**
Other assets	**19,632**	**–**	**–**	**–**	**–**	**215,647**	**235,279**
Total assets	**2,112,596**	**733,844**	**410,025**	**1,566,544**	**14,315**	**250,790**	**5,088,114**
Liabilities							
Deposits by banks	**475,034**	**440,000**	**260,000**	**1,085,000**	**–**	**–**	**2,260,034**
Customer accounts	**1,047,298**	**269,151**	**150,067**	**511,734**	**–**	**200,339**	**2,178,589**
Other liabilities	**75,904**	**–**	**–**	**–**	**–**	**92,361**	**168,265**
Subordinated liabilities	**95,164**	**–**	**–**	**–**	**–**	**–**	**95,164**
Shareholders' equity	**–**	**–**	**–**	**–**	**–**	**386,062**	**386,062**
Total equity and liabilities	**1,693,400**	**709,151**	**410,067**	**1,596,734**	**–**	**678,762**	**5,088,114**
Interest rate sensitivity gap	**419,196**	**24,693**	**(42)**	**(30,190)**	**14,315**	**(427,972)**	**–**
Cumulative interest rate sensitivity gap	**419,196**	**443,889**	**443,847**	**413,657**	**427,972**	**–**	**–**

At 31 Dec 2019	Not more than 3 months £'000	Between 3 and 6 months £'000	Between 6 months and 1 year £'000	Between 1 and 5 years £'000	More than 5 years £'000	Non-interest bearing £'000	Total £'000
Assets							
Loans and advances to banks	1,485,247	45,000	65,000	105,000	–	–	1,700,247
Loans and advances to customers	798,499	776,828	383,995	1,752,169	31,556	395,419	4,138,466
Other assets	23,911	455	821	3,212	180	162,711	191,290
Total assets	2,307,657	822,283	449,816	1,860,381	31,736	558,130	6,030,003
Liabilities							
Deposits by banks	705,000	705,000	310,000	1,335,000	–	–	3,055,000
Customer accounts	1,304,880	115,240	149,310	553,885	–	–	2,123,315
Other liabilities	144,070	–	–	–	–	194,708	338,778
Subordinated liabilities	95,202	–	–	–	–	–	95,202
Shareholders' equity	–	–	–	–	–	417,708	417,708
Total equity and liabilities	2,249,152	820,240	459,310	1,888,885	–	612,416	6,030,003
Interest rate sensitivity gap	58,505	2,043	(9,494)	(28,504)	31,736	(54,286)	–
Cumulative interest rate sensitivity gap	58,505	60,548	51,054	22,550	54,286	–	–

27. Legal proceedings and other regulatory matters

The Entity is party to legal proceedings and regulatory matters arising out of its normal business operations. The Entity considers that none of these matters are material.

28. Related party transactions

(a) Transactions with Key Management Personnel

Key Management Personnel ('KMP') are defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Entity directly and indirectly and include members of the Board of Directors of the Entity, and the Board of Directors of HSBC UK Bank plc.

IAS 24 'Related Party Disclosures' requires the following additional information for key management compensation.

A number of KMP are not directors of the Entity and are paid by other HSBC Group companies which make no recharge to the Entity. It is not possible to make reasonable apportionment of their emoluments in respect of the Entity. Accordingly, no emoluments in respect of these KMP are included in the following disclosure.

Members of the Entity's Exec Co are not considered KMP as it is the body of the Exec Co, not individual members, that has the authority and responsibility for planning, directing and controlling the activities of the Entity. 2020 numbers have been prepared on this basis.

The following represents the compensation for Directors of the Entity in exchange for services rendered to the Entity for the period they served during the year.

Compensation of Key Management Personnel

	2020 **£'000**	2019 £'000
Short-term employee benefits	**722**	921
Post-employment benefits	**35**	53

Transactions, arrangements and agreements with Key Management Personnel [1]

The table below sets out transactions which fall to be disclosed under IAS 24 'Related Party Disclosures' between the Entity and its Key Management Personnel.

	2020		2019	
	Highest balance during the year	**Balance at 31 December**	Highest balance during the year	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Cards	**31**	**12**	36	14
Other[2]	**52**	**51**	100	51

[1] *Includes close family members*

[2] *Other includes saving and insurance products*

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

(b) Transactions with other related parties

Transactions detailed below include amounts due to/from HSBC Bank plc and its subsidiaries

	2020		2019	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Liabilities				
Other liabilities	**8,425**	**2,688**	32,376	7,342

1 *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2020	2019
	£'000	£'000
Income statement		
Interest expense	**2,929**	3,317
Fee income	**98**	–
General and administrative expenses	**35,319**	28,124

Transactions detailed below include amounts due to/from HSBC Holdings plc

	2020		2019	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Liabilities				
Subordinated amounts due	**–**	**–**	79,755	–
Additional tier 1 equity	**–**	**–**	60,000	–

[1] *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2020	2019
	£'000	£'000
Income statement		
Interest expense	**–**	1,615
Dividend expense	**–**	3,416

Transactions detailed below include amounts due to/from Marks and Spencer Savings and Investments Limited and/or Marks and Spencer Unit Trust Management Limited

	2020		2019	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Assets				
Other assets	**5,052**	**5,052**	4,813	4,813
Liabilities				
Other liabilities	**10,491**	**10,491**	11,844	11,844

[1] *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2020 £'000	2019 £'000
Income statement		
Interest expense	**18**	66
General and administrative expenses	**2,820**	2,995

The above transactions were made in the ordinary course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with persons of a similar standing or, where applicable, with other employees. The transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Transactions detailed below include amounts due to/from HSBC UK Bank Plc

	2020		2019	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Assets				
Loans and advances to banks	**2,635,135**	**1,613,594**	1,885,871	1,700,247
Other assets	**45,224**	**35,854**	51,759	30,396
Liabilities				
Deposits by banks	**3,030,000**	**2,260,000**	3,100,000	3,055,000
Subordinated amounts due	**16,000**	**16,000**	16,000	16,000
Additional tier 1 equity	**9,000**	**9,000**	9,000	9,000
Other liabilities	**12,151**	**7,900**	20,779	11,514

[1] *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2020 £'000	2019 £'000
Income statement		
Interest income	**6,201**	13,273
Interest expense	**21,496**	27,519
Fee income	**32**	–
Fee expense	**–**	146
General and administrative expenses	**3,874**	4,407

Transactions detailed below include amounts due to/from HSBC UK Holdings Limited

	2020		2019	
	Highest balance during the year [1]	**Balance at 31 December**	Highest balance during the year [1]	Balance at 31 December
	£'000	**£'000**	£'000	£'000
Liabilities				
Subordinated amounts due	**79,733**	**79,159**	79,789	79,193
Additional tier 1 equity	**60,000**	**60,000**	60,000	60,000

[1] *The disclosure of the year-end balance and the highest balance during the year is considered the most meaningful information to represent transactions during the year.*

	2020 £'000	2019 £'000
Income statement		
Interest expense	**2,929**	1,702
Dividend expense	**4,575**	1,144

29. Parent undertakings

The ultimate parent undertaking and ultimate controlling party is HSBC Holdings plc which is the parent undertaking of the largest group to consolidate these financial statements. HSBC UK Bank plc is the parent undertaking of the smallest group to consolidate these financial statements.

All companies are registered in England and Wales.

Copies of HSBC Holdings plc's and HSBC UK Bank plc's consolidated financial statements can be obtained from:

HSBC Holdings plc
8 Canada Square
London E14 5HQ
United Kingdom
www.hsbc.com

HSBC UK Bank plc
1 Centenary Square
Birmingham B1 1HQ
United Kingdom
www.hsbc.com

30. Events after balance sheet date

No significant events affecting the Entity have occurred since the end of the financial year.